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91-1586

No. 91-_____

Supreme Court, U.S.
FILED
1992 23

IN THE

Supreme Court of the United States

October Term, 1991

SUPER VALU STORES, INC.,
Petitioner,

v.

IOWA DEPARTMENT OF REVENUE AND FINANCE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF IOWA

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether this Court should now, for the first time and in response to state court conflicts, apply the criteria prescribed in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983), to determine whether the Due Process and Commerce Clauses preclude a state from imposing a tax on income derived by a nondomiciliary corporation from the sale of the stock of a subsidiary upon the theory that a unitary business relationship exists between the two corporations, if the corporations are engaged in neither the same line of business nor successive steps in a vertically structured business.

PARTIES TO THE PROCEEDING

The names of all of the parties to the proceeding in the Supreme Court of Iowa appear in the caption.

RULE 29.1 STATEMENT

Super Valu Stores, Inc. has no parent company. Its subsidiaries (except wholly owned subsidiaries) are Dayton Foods Limited Partnership, Dayton Foods Limited Partnership II, Hyper Shoppes, Inc., Independent Holdings Limited, N.A., Data Processors, Ltd., North American Data Processors, Inc., ShopKo Stores, Inc., Super Discount Markets, Inc., and S W Partnership.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES v

OPINIONS BELOW 1

JURISDICTION 2

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED 2

STATEMENT OF THE CASE 3

1. The Super Valu and County Seat Businesses and the Sale of County Seat 4

2. The Tax Assessment 5

3. The i ɔceedings Below 7

REASONS FOR GRANTING TH E WRIT 10

I. THE DECISION BELOW CONFLICTS WITH THE DECISIONS OF OTHER STATE COURTS 10

II. THE DECISION BELOW CONFLICTS WITH APPLICABLE DECISIONS OF THIS COURT 18

Page

III. THIS IS THE APPROPRIATE TIME FOR THE COURT TO DECIDE WHETHER THE UNITARY BUSINESS CONCEPT IS TO BE APPLIED TO CORPORATIONS ENGAGED IN DIVERSE BUSINESSES 25

CONCLUSION 27

APPENDIX 1a

Appendix A: Opinion of the Supreme Court of Iowa, December 24, 1991 ..... 1a

Appendix B: Opinion of the Iowa District Court for Polk County, September 21, 1990 ..... 13a

Appendix C: Order of the Iowa State Department of Revenue and Finance, July 31, 1989 ..... 20a

Appendix D: Iowa Statutes and Regulations Involved 65a

TABLE OF AUTHORITIES

Page(s)

Cases

Allied-Signal Inc. v. Director, Division of Taxation, cert. granted, 112 S.Ct. 632 (Nov. 27, 1991) (No. 91-615) . . . . . 3 n. 1, 17 n. 6, 23 n. 9, 27-28

ASARCO, Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982) . . . . . 3 n. 1, 6, 7, 8, 9, 13 n. 3, 15, 20 n. 8, 27

Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924) 20

Bendix Corp. v. Director, Division of Taxation, 125 N.J. 20, 592 A.2d 536 (1991) . . . . . 17 n. 6, 23 n. 9

Butler Bros. v. McColgan, 315 U.S. 501 (1942) 9, 19

Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983) . . . . . *passim*

Corn Products Refining Co. v. Commissioner, 350 U.S. 46, 50-53 (1955) 21

Dental Insurance Consultants, Inc. v. Franchise Tax Board, 1 Cal. App. 4th 343, 1 Cal. Rptr. 2d 757 (1991), *pet. for rev. denied* (Cal. Jan. 30, 1992) . . . . . 13 n. 3

Page(s)

Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207 (1980) 14-15, 18, 19

F.W. Woolworth Co. v. Taxation and Revenue Dept., 458 U.S. 354 (1982) . . . . . 3 n. 1, 6, 8, 12, 13 n. 3, 14, 15, 19, 22, 26, 27

F.W. Woolworth Co. v. Franchise Tax Board, 160 Cal. App.3d 1154, 207 Cal. Rptr. 149 (1984), *pet. for rev. denied* (Cal. Jan. 24, 1985) . . . . . 13 n. 3

Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123 (1931) 19-20

Holloway Sand & Gravel Co. v. Department of Treasury, 152 Mich. App. 823, 393 N.W.2d 921 (1986) 15-16

Jaffe v. Department of Treasury, 172 Mich. App. 116, 431 N.W.2d 416 (1988), *app. denied*, 432 Mich. 911 (1989), *cert. denied*, 493 U.S. 1025 (1990) . . . . . 16 n. 5, 17 n. 7

James v. International Telephone & Telegraph Corp., 654 S.W.2d 865 (Mo. 1983) 14-15

Luhr Bros., Inc. v. Director of Revenue, 780 S.W.2d 55 (Mo. 1989) . . . . . 15 n. 4

Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980) . . . . . 6, 13 n 3, 15, 18, 19

Page(s)

Mole-Richardson Co. v. Franchise Tax Board, 220 Cal. App.3d 889, 269 Cal. Rptr. 662, *mod.*, 221 Cal. App.3d 425a (1990), *pet. for rev. denied* (Cal. Aug. 8, 1990) ..... 13 n. 3

Pentzien, Inc. v. State Department of Revenue, 227 Neb. 434, 418 N.W.2d 546 (1988) ..... 16, 17 n. 7

Ramsay, Scarlett & Co. v. Comptroller of the Treasury, 302 Md. 825, 490 A.2d 1296 (1985) ... 16 n. 5

Russell Stover Candies, Inc. v. Department of Revenue, 665 P.2d 198 (Mont.), *app. dismissed*, 464 U.S. 988 (1983)..... 17 n. 7

Silent Hoist & Crane Co. v. Director, Division of Taxation, 100 N.J. 1, 494 A.2d 775, *cert. denied*, 474 U.S. 995 (1985) ..... 17 & n. 6, n. 7

Tenneco West, Inc. v. Franchise Tax Board, 234 Cal. App. 3d 1510, 286 Cal. Rptr. 354 (1991), *pet. for rev. denied* (Cal. Jan. 30, 1992),..... 11-13, 26

Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920) 20

Constitutional Provisions

U.S. Const., amend. XIV, § 1,..... 2

U.S. Const., art. I, § 8, cl. 3 2

Page(s)

Statutes and Regulations

28 U.S.C. § 1257(a) 2

Iowa Code § 422.32 . . . . . 2, 6

Iowa Code §§ 422.32-422.41 5

Iowa Code § 422.33 . . . . . 2, 5-6

Iowa Code § 422.35 2

Iowa Administrative Code,
Rule 701-54.1(422) 2, 6

Iowa Administrative Code,
Rule 701-54.2(422) . . . . . 2, 6, 23 n. 10

Iowa Administrative Code,
Rule 701-54.4(422) 2, 6

IN THE

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October Term, 1991

No. 91–

SUPER VALU STORES, INC.,

Petitioner,

v.

IOWA DEPARTMENT OF REVENUE AND FINANCE,

Respondent.

Petition for a Writ of Certiorari to the Supreme Court of Iowa

PETITION FOR A WRIT OF CERTIORARI

Super Valu Stores, Inc. ("Super Valu") petitions for a writ of certiorari to review the judgment of the Supreme Court of Iowa in this case.

OPINIONS BELOW

The opinion of the Supreme Court of Iowa (App. A at 1a-12a) is reported at 479 N.W.2d 255 (Iowa 1991). The Ruling of the Iowa District Court for Polk County (App. B

at 13a-19a) is unreported. The Order of the Director of the Iowa Department of Revenue and Finance (App. C at 20a-64a) is unreported.

JURISDICTION

The judgment of the Supreme Court of Iowa was entered on December 24, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

The Due Process Clause of the Fourteenth Amendment of the United States Constitution, U.S. Const., amend. XIV, § 1, provides in pertinent part: "[N]or shall any state deprive any person of life, liberty, or property without due process of law."

The Commerce Clause of the United States Constitution, U.S. Const., art. I, § 8, cl. 3, provides that "[t]he Congress shall have power . . . [t]o regulate commerce with foreign nations, and among the several states, and with the Indian tribes. . . ."

Relevant portions of the statute imposing the Iowa Business Tax on Corporations (corporation income tax), Iowa Code §§ 422.32(6), (7), (8), 422.33(1), (2), and 422.35, and of the regulations promulgated thereunder, Iowa Administrative Code, Rules 701-54.1(422), 701-54.2(1)(422) and 701-54.4(422), are reproduced at App. D at 65a-69a.

STATEMENT OF THE CASE

The issue raised by this case concerns the power of a state to tax the income derived by a nondomiciliary corporation from its investment in a subsidiary upon the theory that a unitary business relationship exists between the two corporations, if the corporations are engaged in neither the same line of business nor successive steps of a common process in a vertically integrated business. The precise question is whether Iowa may tax a share of the gain that Super Valu, a wholesale grocery firm domiciled in Minnesota, realized upon the sale of the stock of its subsidiary, County Seat Stores, Inc. ("County Seat"), a specialty retail clothing firm.[1]

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1 The question presented in this case is related to, yet distinct from, the question presented in a New Jersey case now pending before the Court, *Allied-Signal Inc. v. Director, Division of Taxation, cert. granted,* 112 S.Ct. 632 (Nov. 27, 1991) (No. 91-615), *oral argument heard on* March 4, 1992. The issue presented in *Allied-Signal* is whether a state may tax the income earned by a nondomiciliary corporation from its investment in a corporation with which it concededly lacks a unitary business relationship if the purchase and sale of the stock of the subsidiary play an integral role in the parent's business operations. In the present case, Iowa has predicated the taxability of Super Valu's income from the sale of the County Seat stock solely upon the purported existence of a unitary business relationship between parent and subsidiary. On March 11, 1992, *Allied-Signal* was calendared for reargument on April 22, 1992 to address the question whether the Court should overrule *ASARCO, Inc. v. Idaho State Tax Commission,* 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation and Revenue Dept.,* 458 U. S. 354 (1982), and related retroactivity issues. Whether *ASARCO* and *Woolworth* are reaffirmed or overruled, certiorari should be granted in the present case. See pp. 26-27, *infra*.

1. The Super Valu and County Seat Businesses and the Sale of County Seat

Super Valu is a Delaware corporation with its corporate headquarters and commercial domicile in Minnesota. During its taxable year ended February 1985, Super Valu sold food and other grocery store products at wholesale to independently owned supermarkets in approximately 28 states, including Iowa. County Seat operated specialty retail clothing stores. Its business had originated as a division of Super Valu in 1973 and was transferred in 1976 to County Seat, a newly organized and wholly-owned subsidiary of Super Valu. App. C at 28a. Iowa seeks to tax an apportioned share of the gain realized by Super Valu upon its sale of the stock of County Seat in May 1984.

Although Super Valu and County Seat had certain directors and officers in common, no officer was involved in the day-to-day management of both companies. The President of County Seat was experienced in the retail clothing business and was employed to establish and manage the County Seat business in 1973. He continued to do so through the time of the sale of County Seat by Super Valu in 1984. App. A at 3a-4a. The product lines of the two companies were entirely different. There were no intercompany sales of inventory, supplies, or equipment, and neither of the companies purchased these items for the other. County Seat's product distribution system and warehouse facilities were entirely separate from those of Super Valu. Super Valu and County Seat did not share brand names, logos, packaging systems, patents, copyrights, trademarks, or customer lists. Their advertising activities

were separate, and they performed no research or product development services for each other. There were few transfers of personnel between the companies. App. C at 29a-30a.

Super Valu provided minimal management oversight of County Seat. It approved County Seat's capital and operating budgets, but did not make or approve any of County Seat's business decisions. It provided certain management services to County Seat – including cash management, payroll, insurance purchasing, in-house legal services, tax return preparation, and accounting services – and allocated the fair cost of those services to County Seat. App. C at 33a-35a.

Super Valu and its subsidiaries, including County Seat, maintained a common cash management system under which cash generated by all of the entities was concentrated and made available to those that required it. All external borrowing was done by Super Valu. Interest credits and charges were attributed to each entity under a capital contribution/usage system designed to reflect the position of each entity as a capital generator or user. App. C at 34a.

On May 25, 1984, Super Valu sold its County Seat stock and realized a capital gain of approximately $41 million. App. C at 28a.

2. **The Tax Assessment**

Iowa imposes its Business Tax on Corporations (corporation income tax), Iowa Code §§ 422.32-422.41, upon every corporation organized under its laws, doing business within the state, or deriving income from sources within

the state. *Id.* § 422.33(1) (App. D at 65a). If the trade or business of the corporation is carried on partly within and partly without Iowa, the tax is measured by an apportioned share of net "business income" plus any "nonbusiness income" allocable to Iowa. *Id.* § 422.33(1), (2) (App. D at 65a-67a).

Investment income (such as capital gain) is treated as apportionable "business income" if earned "as a part of a corporation's unitary business." Iowa Admin. Code, Rule 701-54.2(1)(422) (App. D at 68a). The Rule cites as authority the decisions of this Court in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982); *F.W. Woolworth Co. v. Taxation and Revenue Dept.*, 458 U.S. 354 (1982); and *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983). The Rule also creates a rebuttable presumption that "an affiliated group of corporations in the same line of business have a unitary relationship." *See also* Iowa Admin. Code, Rule 701-54.4(422) (App. D at 69a) (gain from sale of intangible personal property used in trade or business is apportionable income).

"Business income," including capital gain so classified, is apportioned to Iowa in the proportion that Iowa sales bear to total sales. Iowa Code § 422.33(2)(b)(2) & (4) (App. D at 66a-67a); *see also* Iowa Admin. Code, Rule 701-54.1(422) (App. D at 67a-68a). Nonbusiness capital gains from the sale of intangible personal property are allocable to Iowa only if the taxpayer's "commercial domicile" is in that state. *Id.* § 422.33(2)(a)(4) (App. D at 66a). "Commercial domicile" is the "principal place from which the trade or business of the taxpayer is directed or managed." *Id.* § 422.32(8) (App. D at 65a).

On its Iowa income tax return for the taxable year ended February 1985, Super Valu excluded from its net income the gain on the sale of its County Seat stock on the grounds that the gain constituted nonbusiness income of a nondomiciliary corporation attributable to intangible personal property, and therefore was neither includible in apportionable income nor allocable to Iowa under Iowa law, and, further, that Iowa could not constitutionally tax any portion of the gain of a nondomiciliary corporation attributable to the sale of the stock of a subsidiary with which the taxpayer lacked a unitary business relationship. On audit, the Iowa Department of Revenue and Finance determined that the gain was apportionable business income and assessed additional tax.

3. The Proceedings Below

How the federal questions were raised and passed on below. In its protest and briefs filed with the Iowa Department of Revenue and Finance, in its petition for judicial review and briefs filed with the Iowa District Court, and in its briefs filed with the Supreme Court of Iowa, Super Valu contended that the federal Constitution precluded Iowa from taxing its income from the sale of the County Seat stock. The Department and each court noted and ruled upon Super Valu's federal constitutional objections in its opinion. *See* App. A at 7a-10a; App. B. at 16a-18a; App. C at 39a-41a, 43a-44a, 46a-51a, 60a-63a.

The decisions below. The Iowa Department of Revenue and Finance acknowledged that "the 'unitary business' doctrine underlies the use of formulary apportionment," and that under this Court's decisions in *ASARCO* and

Woolworth, "something more is needed [to establish a unitary business relationship] than evidence of common ownership, high-level executive oversight and certain centralized nonoperating functions, such as accounting, legal and financing services; and something more than just adding to the profit of the parent." App. C at 39a, 49a. The Department also recognized that Super Valu and County Seat were engaged in "diverse" businesses and stated that the characterization of such a relationship as "unitary" or "non-unitary" is "difficult." App. C at 45a. It stated, however, that this Court's decisions in *ASARCO* and *Woolworth* stand "in contrast" to its decision in *Container*, App. C at 50a, and that the Court had broadened the "unitary business" concept in *Container* by holding that "the prerequisite to a constitutionally acceptable finding of unitary business is a flow of value . . . ." 463 U.S. at 178. App. C at 60a. The Department stated that a "striking" parallel exists between the facts of *Container* and this case (App. C at 60a), without acknowledging that in *Container* (a) the parent and subsidiaries were engaged in the same line of business and (b) the Court distinguished (463 U.S. at 178, 180 n. 19) between that case and cases in which the entities are engaged in different businesses. Relying largely upon *Container*, the Department held that a unitary business relationship existed between Super Valu and County Seat.

The Iowa District Court affirmed the Department's Order in a Ruling that contained neither a comprehensive statement of the applicable legal standard nor a discussion of the facts. App. B at 13a-19a. The District Court rested its decision, as had the Department, upon purported factual similarities between this case and *Container*, but relied only upon conclusory statements in the Department's Order

while ignoring the important differences between the two cases arising from the fact that Container and its subsidiaries were engaged in the same line of business while Super Valu and County Seat were not.

The Supreme Court of Iowa affirmed the decision of the District Court. It recognized that under the Due Process and Commerce Clauses "a state may not impose an income-based tax on 'value earned outside its borders,'" quoting *Container*, 463 U.S. at 164, and *ASARCO*, 458 U.S. at 315, and that under this standard Iowa may not tax Super Valu's gain on sale of the County Seat stock unless a unitary business relationship existed between the two corporations. App. A at 7a. It cited *Container* for the principle that a unitary business relationship may be predicated upon "common managerial or operational resources" that produce "economies of scale and transfers of value" (*Container*, 463 U.S. at 166), App. A at 9a, but failed to note that in *Container* this principle was expressly applied to "similar enterprises," 463 U.S. at 166, and that both *Container* and *Butler Bros. v. McColgan*, 315 U.S. 501 (1942), the authority cited in *Container* for the principle, involved "similar enterprises."

The Iowa court acknowledged that Super Valu had "not actually exercised" day-to-day control of County Seat. App. A at 10a. In concluding that a unitary business relationship nonetheless existed, it relied upon the existence of some common officers and directors, the authority of Super Valu to hire the president of County Seat and fix his compensation, the sharing of certain staff and cash management services, the review and approval of County Seat's budgets by Super Valu, and intercompany financing. App. A at 10a-12a.

Like the Department and the District Court, the Supreme Court failed to address the distinctions emphasized by this Court in *Container* between investments in subsidiaries engaged in "distinct" businesses and those engaged in the "same line of work," between capital transactions that serve an "investment function" and those that serve an "operational function," and between management oversight that "any parent gives to an investment in a subsidiary" and that which is grounded in the parent's "own operational expertise" and "overall operational strategy." *See Container*, 463 U.S. at 178, 180 n. 19.

REASONS FOR GRANTING THE WRIT

The Court should grant a writ of certiorari to review the decision of the Supreme Court of Iowa for three reasons. First, the holding of the Iowa court that a "unitary business" relationship exists between two companies engaged in completely distinct businesses directly conflicts with the post-*Container* decisions of other state courts. Second, the decision of the Iowa court is incompatible with the decisions of this Court (including *Container*, on which the Iowa court particularly relies). Third, this is the appropriate time for the Court to decide how the unitary business concept is to be applied to corporations engaged in diverse businesses.

I. THE DECISION BELOW CONFLICTS WITH THE DECISIONS OF OTHER STATE COURTS.

In holding that a "unitary business" relationship exists between two companies engaged in distinct lines of business, the Iowa decision conflicts with the post-*Container*

decisions of state courts in California, Missouri, and Michigan. These courts have ruled, on facts similar to those presented by this case, that a unitary business relationship does not exist between companies engaged in diverse businesses.

In *Tenneco West, Inc. v. Franchise Tax Board*, 234 Cal. App. 3d 1510, 286 Cal. Rptr. 354 (1991), *pet. for rev. denied* (Cal. Jan. 30, 1992), the California Court of Appeal held that the subsidiaries of Tenneco Inc. ("Tenneco") engaged in shipbuilding, packaging, automotive parts manufacturing, and the manufacture and sale of construction and farm equipment ("Excluded Subsidiaries") were not engaged in a unitary business with the parent and other subsidiaries engaged in oil and oil-related businesses, and therefore did not qualify to be included in a combined-reporting tax return group with the parent and other subsidiaries.[2]

There were certain managerial links and financial relationships among the parent and all of the subsidiaries. Parental approval was required for capital expenditures exceeding $100,000 and for all salaries exceeding $25,000 (later $50,000). Each division was required to submit annually to the parent a detailed five-year business plan. There was a centralized corporate policy and procedure manual. There were centralized personnel standards and planning programs, centralized employee benefit plans,

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2 Under the combined reporting method, a corporation engaged in a unitary business with affiliated corporations reports the total income of the unitary business, which is then apportioned to the taxing state by means of an apportionment formula based on the ratio of the in-state activities of the reporting corporation to the activities of the unitary business everywhere. *See Container*, 463 U.S. at 168 & n. 5.

and some centralized legal, tax, insurance, and accounting functions. There was also substantial centralized financing of capital needs. 286 Cal. Rptr. at 358-359. On the other hand, there was "minimal" common advertising, "little or no" centralized research, "insubstantial" intercompany sales and common purchasing, no common sales force, and "insubstantial" common warehousing, customer ordering systems, and fabrication and manufacturing facilities. 286 Cal. Rptr. at 360.

In holding that the Excluded Subsidiaries did not share a unitary business relationship with the parent and other subsidiaries, the California court relied primarily on *Woolworth* and *Container*. It found that Tenneco had "weak central management" and lacked "substantial centralized departments," that its subsidiaries "had a history of separateness *and were of a diverse unrelated nature,*" and that Tenneco's "inter-company financing served an investment function, not an operational function." 286 Cal. Rptr. at 366 (emphasis added). In finding "weak central management," the court noted that Tenneco granted substantial operational autonomy to the subsidiaries and that its involvement in the management, planning, review, audit, financial, cash management and insurance functions of the subsidiaries constituted "the kind of behavior that one would expect to find in any parent subsidiary or parent division relationship." 286 Cal. Rptr. at 363. In analyzing the centralized financing between Tenneco and the subsidiaries, the court relied explicitly on *Container*, 463 U.S. at 178, 180 n. 19, in concluding that Tenneco's investment in the Excluded Subsidiaries "primarily served to diversify its corporate portfolio and reduce business cycle risks instead of making better use of Tenneco's existing resources," 286

Cal. Rptr. at 365, and accordingly served "an investment function, not an operational function," 286 Cal. Rptr. at 366. Thus, faced with facts similar to those in the present case – distinct lines of business, little centralization of management, some common staff functions, and intercompany financing – the California court concluded that a unitary business relationship did not exist.[3]

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3 *See also F.W. Woolworth Co. v. Franchise Tax Board*, 160 Cal. App. 3d 1154, 207 Cal. Rptr. 149 (1984), *pet. for rev. denied* (Cal. Jan. 24, 1985), in which the California Court of Appeal held that a parent and its subsidiaries engaged in a retail store business were not unitary despite the existence of interlocking boards of directors and financial controls.

In *Mole-Richardson Co. v. Franchise Tax Board*, 220 Cal. App. 3d 889, 269 Cal. Rptr. 662, *mod.*, 221 Cal. App. 3d 425a (1990), *pet. for rev. denied* (Cal. Aug. 8, 1990), the taxpayer, a corporation domiciled in California, contended that diverse businesses conducted by itself and two affiliates in California and Colorado were unitary on the basis of services performed in California for the benefit of all of the businesses. The State opposed unitary treatment, arguing that substantial functional integration did not exist in light of the diverse character of the businesses.

The California Court of Appeal held that a unitary business existed. The court, however, distinguished *Mobil*, *ASARCO*, and *Woolworth* on the ground that they concerned a *nondomiciliary* parent corporation performing centralized management activities outside the taxing state, implying that a lower standard of unity applies under California law to cases involving centralized management conducted in California by a California-domiciled parent. 269 Cal. Rptr. at 666. *Mole-Richardson* therefore does not detract from the position of the California Court of Appeal in *Tenneco* that nondomiciliary corporations engaged in diverse businesses lack the functional integration that is the prerequisite of a unitary business. (*Mole-Richardson* was followed in *Dental Insurance Consultants, Inc. v. Franchise Tax Board*, 1 Cal. App. 4th 343, 1 Cal. Rptr. 2d 757 (1991), *pet. for rev. denied* (Cal. Jan. 30, 1992), which also involved a corporation domiciled in California.)

In *James v. International Telephone & Telegraph Corp.*, 654 S.W.2d 865 (Mo. 1983), the Missouri Supreme Court declined to find a unitary business relationship between ITT (engaged in the electronics and telecommunications business) and four wholly-owned subsidiaries (engaged in automobile renting and leasing, food vending and distribution, and insurance sales). *Id.* at 869. The court therefore held that Missouri could not include the gain realized by ITT upon sale of the subsidiaries in apportionable income.

Employees of ITT sat on some of the subsidiaries' boards of directors and, for a fee, ITT performed tax, accounting, and other services for some of the subsidiaries. 654 S.W.2d at 866. ITT also performed legal services for the subsidiaries, and the ITT Comptroller's Department reviewed the operations of the subsidiaries and gave advice on cost reduction and the improvement of profitability. *ITT*, Brief of Appellant at 5.

The court stated that in *ASARCO*, *Woolworth* and *Container* this Court had "rejected the claim that an investment relationship such as the one that exists here constitutes a unitary business." 654 S.W.2d at 868. It noted that the subsidiaries "were not engaged in any aspect of the electronics or telecommunications business" of ITT or in any "support business," and concluded:

> [T]here was no "functional integration," *Woolworth*, 102 S. Ct. at 3135 [458 U.S. at 364], either vertical or horizontal, between ITT and any of the subsidiaries in question. *See id.* at 3138-39 [458 U.S. at 371]. *Cf. Exxon*, 447 U.S. at 210, 224, 100 S. Ct. at 2113, 2120

> (vertically integrated petroleum business); *Mobil*, 445 U.S. at 428, 439-40, 100 S. Ct. at 1227, 1232-33 (same). There was no real "centralization of management," nor were there "economies of scale." *Woolworth*, 102 S. Ct. at 3135 [458 U.S. at 364]. In short, the subsidiaries were "discrete business enterprise[s]," the business activities of which had "nothing to do with the activities of [ITT] in [Missouri]." *Mobil*, 445 U.S. at 439, 442, 100 S. Ct. at 1232, 1234.

654 S.W.2d at 869.[4]

In *Holloway Sand & Gravel Co. v. Department of Treasury*, 152 Mich. App. 823, 393 N.W.2d 921 (1986), the Michigan Court of Appeals held that the taxpayer's Texas speedway operation was not unitary with its Michigan sand and gravel operation although administrative and financial services were centralized at the Michigan offices of the company and major decisions were made by the same executive officers overseeing both enterprises. 393 N.W.2d at 926. In weighing the significance of these facts, the court relied upon *Mobil, Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 267 (1980), *Woolworth, ASARCO*, and *Container*. The most important feature in *Holloway* was the lack of functional integration: "[A]lthough administrative services were centralized in Michigan, the sand and gravel enterprise was so functionally different from the speedway

4 *Compare Luhr Bros., Inc. v. Director of Revenue*, 780 S.W.2d 55 (Mo. 1989) (corporation and partnership engaged in similar business activities constituted unitary business; court emphasizes that operational expertise of chief executive officer of corporation was used in making partnership decisions).

that it is difficult to perceive how there could be functional integration." *Id.* at 925. In the absence of functional integration, the court did not find the evidence of centralized management and financial services sufficient to support a unitary business finding.[5]

Although the courts of California, Missouri and Michigan have thus ruled, contrary to the Supreme Court of Iowa, that companies engaged in distinct lines of business are not engaged in a unitary business even when they share certain management functions and financial relationships, the Iowa court is not alone in finding a unitary business to exist under such circumstances since *Container* was decided. In *Pentzien, Inc. v. State Department of Revenue*, 227 Neb. 434, 418 N.W.2d 546 (1988), the taxpayer operated a pipeline construction business and a horse farm. The Nebraska court held the horse farm operation to be unitary with the pipeline construction business on the basis of centralized

5 In *Jaffe v. Department of Treasury*, 172 Mich. App. 116, 431 N.W.2d 416 (1988), *app. denied*, 432 Mich. 911 (1989), *cert. denied*, 493 U.S. 1025 (1990), the Michigan court affirmed the principles of *Holloway* and held that two dissimilar businesses operated through a sole proprietorship (*i.e.*, advertising and cattle ranching) were non-unitary, despite strong centralized management by a single person. 431 N.W.2d at 418-419.

In *Ramsay, Scarlett & Co. v. Comptroller of the Treasury*, 302 Md. 825, 490 A.2d 1296 (1985), the Court of Appeals of Maryland held as a matter of state law (490 A.2d at 1303 n.3) that a corporation having its principal place of business in Baltimore, where it was engaged primarily in steamship agency and stevedoring operations, was entitled to determine its income separately from its Louisiana division, which was engaged primarily in warehousing and a barge facility operation, because a unitary business relationship did not exist between the Maryland and Louisiana operations despite the presence of common administrative and financial functions.

management even though the two businesses were not the "same type." 418 N.W.2d at 553. In *Silent Hoist & Crane Co. v. Director, Division of Taxation*, 100 N.J. 1, 494 A.2d 775, *cert. denied*, 474 U.S. 995 (1985), the Supreme Court of New Jersey held that the ownership of two parcels of commercial real estate in New Jersey was unitary with a manufacturing and sales business and a securities investment business conducted in New York.[6] Although the real estate business conducted in New Jersey was neither horizontally nor vertically integrated with the manufacturing and investment businesses conducted in New York, the court concluded that the businesses were unitary because they were operated by a single corporation dominated by one person and funds were transferred among them.[7]

6 The Supreme Court of New Jersey relied in part upon *Silent Hoist* in deciding *Bendix Corp. v. Director, Division of Taxation*, 125 N.J. 20, 592 A.2d 536 (1991), now pending before this Court *sub nom. Allied-Signal Inc. v. Director, Division of Taxation*. *See* note 1, *supra*, at 3.

7 In a pre-*Container* case, *Russell Stover Candies, Inc. v. Department of Revenue*, 665 P.2d 198 (Mont.), *app. dismissed*, 464 U.S. 988 (1983), the Supreme Court of Montana held that two cattle ranches were unitary with a business engaged in the manufacture, distribution, and sale of paper box products. The court relied upon strong centralized management and fund transfers. 665 P.2d at 199. Because the case was decided before *Container*, the Montana court did not analyze the management and financial relationships in the manner required by *Container*. Although this Court dismissed the taxpayer's appeal after *Container* was decided, Justice Stevens would have noted probable jurisdiction.

The dismissal of the appeal in *Russell Stover* did not prevent the development of conflict in the state courts' application of the unitary business concept to diverse businesses. Although two of the decisions discussed in this petition followed *Russell Stover* (*Pentzien*, 418 N.W.2d at 553, and *Silent Hoist*, 494 A.2d at 785), another (*Jaffe*, 431 N.W.2d at 419) did not, asserting that *Russell Stover* was "distinguishable" and "nonbinding."

The decisions of this Court culminating in *Container* have not evoked a consistent response from the state courts on the issue of whether diverse businesses may constitute a unitary business for purposes of state taxation. The decision of the Iowa court in this case is only the latest in a series of decisions in which state courts have ruled in contradictory ways on this question. These decisions indicate that the question is one on which the state courts require further guidance from this Court.

II. THE DECISION BELOW CONFLICTS WITH APPLICABLE DECISIONS OF THIS COURT.

This Court has stated that "[t]he Due Process and Commerce Clauses of the Constitution do not allow a State to tax income arising out of interstate activities – even on a proportional basis – unless there is a '"minimal connection" or "nexus" between the interstate activities and the taxing State, and "a rational relationship between the income attributed to the State and the intrastate values of the enterprise."'" *Container*, 463 U.S. at 165-166, quoting *Exxon*, 447 U.S. at 219-220, quoting *Mobil*, 445 U.S. at 436, 437. In the case of a nondomiciliary corporation, the taxing state can extend its taxing power to activities conducted beyond its borders only if those activities are part of a "unitary business" that includes instate activities. "The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement – beyond the mere flow of funds arising out a passive investment or a distinct business operation – which renders formula apportionment a reasonable method of taxation." *Container*, 463 U.S. at 166.

To determine the existence of such an "exchange of value," the Court has looked to the "contributions to income" resulting from "functional integration, centralization of management, and economies of scale." *Mobil*, 445 U.S. at 438, *quoted in Woolworth*, 458 U.S. at 364, and *Container*, 463 U.S. at 179. Of these three, clearly the most important, and the one stressed in *Container*, is functional integration. *See, e.g.*, 463 U.S. at 179. Functional integration customarily exists only in the case of corporations that are engaged in the same line of business (horizontally integrated) or in successive steps of a common process (vertically integrated). Thus in *Container* the Court found "reasonable" the presumption, on which the California court relied in that case, "that corporations engaged in the same line of business are unitary." 463 U.S. at 178. By the same token, the Court noted that a unitary business finding does not necessarily depend upon a "flow of goods," as would normally occur only in the case of a vertically integrated business, but rather upon a "flow of *value*." *Id.* (emphasis in original). Thus the Court noted that in its prior decisions it had upheld unitary business findings in the context of horizontally, as well as vertically, integrated businesses. 463 U.S. at 166.

Significantly, there has *always* been either a horizontally or a vertically integrated business in the cases in which the Court has upheld a unitary business finding. *See Container* (horizontally integrated paperboard manufacturing business); *Exxon* (vertically integrated petroleum business); *Mobil* (same); *Butler Bros. v. McColgan*, 315 U.S. 501 (1942) (horizontally integrated business); *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123

(1931) (vertically integrated business); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924) (same); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920) (same).[8] Furthermore, although the Court has not excluded the possibility that a unitary business relationship could exist in the absence of either a horizontally or a vertically integrated business, it has made clear that, under such circumstances, the likelihood of a unitary business relationship is greatly diminished if not eliminated. In discussing the California court's presumption in *Container* that corporations engaged in the same line of business are unitary, the Court observed:

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8 In *ASARCO*, the Court struck down a unitary business finding despite certain evidence of horizontal and vertical integration. The dissenting opinion of Justice O'Connor (joined by Justices Blackmun and Rehnquist), which would have upheld the unitary business finding, relied strongly on evidence of such integration (ASARCO invested in corporations engaged in its own nonferrous metals business; it used its expertise in that industry in selecting its investments; the investment in one of the subsidiaries helped ensure ASARCO a source of supply for a raw product used in its business). See *ASARCO*, 448 U.S. at 335-344. This portion of the *ASARCO* dissent is consistent with the opinions cited in the main text in emphasizing the crucial significance, for a unitary business finding, of a horizontally or vertically integrated business. (In Part III of her dissent, Justice O'Connor raised broader concerns about the application of the Court's unitary business test to income apportionment issues. *See* 448 U.S. at 344-349.) *See also Woolworth*, 448 U.S. at 373-374 (O'Connor, J., dissenting) (asserting that a unitary business finding should have been upheld, and stressing that Woolworth was "in the same line of business" as its controlled subsidiaries).

> Investment in a business enterprise truly 'distinct' from a corporation's main line of business often serves the primary function of diversifying the corporate portfolio and reducing the risks inherent in being tied to one industry's business cycle. When a corporation invests in a subsidiary that engages in the same line of work as itself, it becomes much more likely that one function of the investment is to make better use – either through economies of scale or through operational integration or sharing of expertise – of the parent's existing business-related resources.

463 U.S. at 178.

Container makes clear that specific evidence of links between commonly owned corporations acquires a different significance depending upon whether they are engaged in the same or in distinct businesses. In analyzing the relationship between Container Corporation and its subsidiaries, the Court placed particular emphasis on evidence of financial assistance and managerial oversight. In citing each of these factors, however, the Court made clear that they had weight only because the parent and its subsidiaries were engaged in a virtually identical paperboard manufacturing business. In discussing the parent's loans and loan guarantees for the benefit of its subsidiaries, the Court stated: "As we made clear in another context in *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 50-53 (1955), capital transactions can serve either an investment function or an operational function. In this

case, appellant's loans and loan guarantees were clearly part of an effort to ensure that '[t]he overseas operations of [appellant] continue to grow and to become a more substantial part of the company's strength and profitability.'" 463 U.S. at 180 n. 19 (citation omitted). Similarly, in discussing managerial oversight, the Court reiterated its statement in *Woolworth* that "a unitary business finding [can] not be based merely on 'the type of occasional oversight – with respect to capital structure, major debt, and dividends – that any parent gives to an investment in a subsidiary . . . .' 458 U.S., at 369. . . . The difference [between management that indicates a unitary business and that which does not] lies in whether the management role that the parent does play is grounded in its own operational expertise and its overall operational strategy." 463 U.S. at 180 n. 19. In analyzing the type of management exercised by Container over its subsidiaries – including the establishment of business "guidelines" and the provision of technical expertise, both made possible by the fact that the parent and the subsidiaries were engaged in the same line of business – the Court concluded that such management indeed indicated an *"operational role"* characteristic of a unitary business. *Id.* (emphasis added).

In its opinion below, the Supreme Court of Iowa repeatedly cited and relied upon *Container* and accepted the principle that a unitary business relationship must exist between Super Valu and County Seat to include the County

Seat gain in Super Valu's apportionable income.[9] It noted that "*Container Corp.* recognized that the unitary business concept is not limited to vertically integrated businesses," and that *Container* required only a flow of value, not a flow of goods. App. A at 9a. Yet the court failed to recognize that *Container* and all of the cases cited in *Container* concerned businesses that were either horizontally or vertically integrated, and that the reference in *Container* to "common managerial or operational resources" as indicators of a unitary business occurred in the context of such businesses. *Container*, 463 U.S. at 166; App. A. at 9a.[10]

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9 For this reason, the decision of the Iowa court raises a different issue from that raised by the decision of the Supreme Court of New Jersey in *Bendix Corp. v. Director, Division of Taxation*, 125 N.J. 20, 592 A.2d 536 (1991), pending before this Court on certiorari *sub nom. Allied-Signal Inc. v. Director, Division of Taxation*. (*See* note 1, *supra.*) *In Bendix*, the New Jersey court rejected the principle that a unitary business relationship must be found between parent and subsidiary to permit the inclusion of gain realized upon sale of the stock of the subsidiary in the parent's apportionable income. Rather, the court held that the unitary business test was satisfied if the parent's *investment* in the subsidiary could be shown to be part of the parent's own "integral operational strategy," in other words, part of its own unitary business. 592 A.2d at 544; *see also* Petitioner's Brief in *Allied-Signal* at 12-13. In the present case, the Iowa court did not base its decision on the theory that Super Valu's investment in County Seat was part of its operational strategy. The Iowa Department of Revenue and Finance did not assert such a theory, and there is no evidence to support its application to this case.

10 The Iowa court also failed to acknowledge that the Iowa Administrative Code, like the California regulation approved in *Container*, distinguishes between similar and diverse businesses by creating a rebuttable presumption that "an affiliated group of corporations in the same line of business have a unitary relationship." Iowa Admin. Code, Rule 701-54.2(1)(422), App. D. at 68a-69a.

Because the court ignored the crucial distinction made in *Container* between similar and diverse businesses, it failed to give weight to certain relevant facts while giving improper weight to other facts. In determining whether Super Valu and County Seat shared a unitary business relationship, it never referred to the fact that the two were engaged in distinct businesses. It ignored the facts that the President of County Seat had been hired because of his experience in the retail clothing business in order to establish and manage the County Seat business, that no officer was involved in the day-to-day management of both Super Valu and County Seat, and that employees of one corporation were not trained at (and did not rotate through) the other corporation. App. A at 3a-4a, 30a. It also ignored the fact that Super Valu provided minimal management oversight of County Seat and neither made nor approved any of County Seat's business decisions. App. C at 29a-30a.

Because the court ignored Super Valu's lack of *operational* expertise in County Seat's business and Super Valu's consequent lack of managerial control of County Seat, it assigned improper weight to certain other facts. It noted, for example, the *potential* for control (though it acknowledged that day-to-day control was not exercised – App. A at 10a) inherent in overlapping directors and officers, but failed to note, as required by *Container*, that *any* control, even if actually exercised, could not have been grounded in "operational expertise" (*Container*, 463 U.S. at 180 n. 19) because Super Valu personnel lacked expertise in the retail clothing business. Likewise, it cited evidence of Super Valu's financial support of County Seat but failed to recognize, as required by *Container*, that a "flow of capital

resources" may well serve an "investment function" rather than an "operational function" when it occurs between corporations engaged in distinct lines of business. 463 U.S. at 180 n. 19.

The Iowa court held in this case that two corporations engaged in distinct lines of business, *i.e.*, neither horizontally nor vertically integrated, shared a unitary business relationship. This Court has *never* so held. In reaching its conclusion, the Iowa court ignored clear indications in *Container* that factors such as centralized management and shared financing have a different, and generally lesser, significance when two corporations are engaged in distinct lines of business and therefore have little capacity to share *operational* expertise or functions. The Iowa court's decision is thus inconsistent with the decisions of this Court and should be reviewed.

III. THIS IS THE APPROPRIATE TIME FOR THE COURT TO DECIDE WHETHER THE UNITARY BUSINESS CONCEPT IS TO BE APPLIED TO CORPORATIONS ENGAGED IN DIVERSE BUSINESSES.

Container, the last case in which this Court applied the unitary business concept, was decided nearly nine years ago. Since that time, the state courts have repeatedly grappled with the concept and, because of the tendency of corporations in recent years to combine into conglomerates engaged in highly diversified businesses, the courts have been asked to decide whether the concept applies to corporations linked by common control but engaged in diverse businesses.

This Court has not decided whether the unitary business concept applies to diverse businesses because all of the Court's cases have involved corporations engaged in the same line of business or successive steps in a vertically integrated business. *Container*, however, suggests that a unitary business relationship does not exist when parent and subsidiary are engaged in diverse businesses because the subsidiary tends in such a case to be a passive investment of the parent, acquired or held for purposes of diversification, and not to be functionally integrated with the parent's operations. 463 U.S. at 178, 180 n. 19.

As demonstrated by the discussion of state court opinions in section I of this petition, *Container* has not prevented the development of genuine conflict among state court decisions concerning diverse businesses. Furthermore, this conflict is not abating, as shown by the very recent conflicting decisions in California (*Tenneco*) and Iowa (this case). Only this Court's attention can resolve the conflict and give much needed guidance to the state courts.

The present case offers the appropriate vehicle to do so. The businesses of Super Valu and County Seat were entirely diverse and offered no room for *operational* integration. At the same time, Super Valu's ownership of County Seat did involve "the type of occasional oversight" that, as noted in *Woolworth* (458 U.S. at 354), "any parent gives to an investment in a subsidiary," and the kinds of financial relationships normally found in any parent/subsidiary relationship. The case thus typifies the situation of corporations sharing common control but engaged in diverse businesses.

The fact that *Allied-Signal* (*see supra*, note 1) is pending before the Court also makes this case timely. In *Allied-Signal*, the Court is considering the continuing vitality of *ASARCO* and *Woolworth* in the context of a case involving corporations that concededly did *not* share a unitary business relationship. The decision of that case is therefore unlikely to shed light upon the manner in which the unitary business concept applies to diverse businesses even if the concept continues to be relevant in the wake of *Allied-Signal*. If the Court reaffirms *ASARCO* and *Woolworth* (retaining the unitary business concept), the application of the concept to diverse businesses will remain an important issue on which the state courts may be expected to continue reaching conflicting conclusions until the matter is decided by this Court. If the Court overrules *ASARCO* and *Woolworth* (abandoning the unitary business concept), but does not give retroactive effect to its decision, the application of the concept to diverse businesses will remain an important issue in pre-existing cases for a considerable time to come. In either event, therefore, the Court should grant certiorari to give plenary consideration to this case.

Alternatively, if *ASARCO* and *Woolworth* are overruled, and the holding is applied retroactively, the Court should grant certiorari in this case, vacate the judgment below, and remand the case to the Supreme Court of Iowa with instructions to reconsider its decision in light of the new principles adopted by this Court to govern state taxation of multistate corporations.

In view of the potential impact of *Allied-Signal* upon the disposition of this petition, the Court may wish to defer acting on the petition until it has announced its decision in *Allied-Signal*.

CONCLUSION

For the reasons stated above, the petition for a writ of certiorari should be granted.

Dated: March 23, 1992

Respectfully submitted,

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APPENDIX A

IN THE SUPREME COURT OF IOWA

SUPER VALU STORES, INC.,
Appellant,
vs.
IOWA DEPARTMENT OF REVENUE AND FINANCE,
Appellee.

No. 320/90-1557

Filed December 24, 1991

Appeal from the Iowa District Court for Polk County, Jack D. Levin, Judge.

Corporate taxpayer appeals from judgment affirming imposition of income tax on sale of subsidiary corporation. **AFFIRMED.**

Considered by McGiverin, C.J., and Larson, Neuman, Snell, and Andreasen, JJ.

LARSON, J.

When Super Valu Stores, Inc. sold a subsidiary corporation, County Seat Stores, Inc., the state of Iowa attempted to subject the capital gain to Iowa income tax. Super Valu resisted on the ground that, while Super Valu itself was subject to Iowa income tax, County Seat and Super Valu were not a "unitary business" for tax purposes, and Super Valu's gain on the sale of County Seat could not be attributed to Super Valu's Iowa income.

The department of revenue and finance, and the district court, rejected this argument. We affirm.

Super Valu is a corporation organized under Delaware law with its principal place of business and commercial domicile in Minnesota. In 1984 it sold all of its stock in County Seat, a wholly owned subsidiary, and realized a long-term capital gain of $41,067,700. On its Iowa income tax return, Super Valu allocated the entire gain to its Minnesota income as a nonbusiness capital gain (thus not subject to Iowa income tax). *See* Iowa Code § 422.33(2)(a)(4) (1989); 701 Iowa Admin. Code 54.4(422).

The department of revenue and finance disagreed with Super Valu's treatment of the gain and classified a portion of it as business income subject to apportionment under Iowa Code section 422.33(2)(b) and Iowa Administrative Code section 701-54.2(422). The department assessed an additional tax of $395,597.23. In the contested case proceeding that followed, the department confirmed the assessment. Super Valu petitioned for judicial review under Iowa Code sections 17A.19 and 422.29, and the district court affirmed.

Super Valu sells food and related products at wholesale to independently owned supermarkets in approximately twenty-eight states and owns several retail stores. It also owned twenty-six subsidiaries during the tax year in question, twenty-four of which were engaged in the wholesale food business or in providing services to the food business. County Seat, and one other subsidiary, ShopKo Stores, Inc., were not engaged in the wholesale food business or activities ancillary to the food business.

Jack Crocker, a Super Valu employee, conceived the idea of entering the clothing business. As a result, County Seat was established in 1973 as a separate division of Super Valu. William S. Bailey was hired as manager.

County Seat was involved in the retail clothing business, usually operating in leased premises in shopping malls. County Seat initially featured Levi Strauss clothing but eventually added sport shoes and fashion clothing.

County Seat's business grew rapidly. By 1976 it had eighty stores, and an additional sixty were planned for the following year. In 1976, Super Valu established County Seat as a separate corporation and transferred to it all of the County Seat assets in exchange for stock and debt. Super Valu also assigned to County Seat all outstanding County Seat contracts, and County Seat assumed all obligations under them. The initial directors of the new County Seat corporation were Jack Crocker, Chairman of the Board of Super Valu, William S. Bailey, and James L. Slovick (who was vice president and treasurer of Super Valu). County Seat's directors elected Bailey as president.

County Seat and Super Valu had separate organizational structures; however, several key personnel had positions in both corporations. County Seat's three directors and five of its twelve officers at the time of its incorporation were also directors and officers of Super Valu. None of the common directors or officers, however, was active in the day-to-day management of both Super Valu and County Seat. Bailey, who was a director and officer of both corporations, was involved only in the

day-to-day management of County Seat.

The remaining two County Seat directors holding positions in both corporations, Crocker and Michael W. Wright, President and Chief Executive Officer of Super Valu, were not involved in the day-to-day management of County Seat. The other four officers with positions in both corporations performed no services for County Seat other than the occasional execution of financial and legal documents, such as tax returns, and they were compensated only by Super Valu. In addition to its own president, County Seat had several of its own vice presidents in charge of various aspects of its business. While two of these County Seat officers had previously been nonofficer employees of Super Valu, none of them had ever worked in Super Valu's food business.

County Seat did not share any brand names, logos, or other indicia of identification with Super Valu, nor were any of the inventories of the two corporations similar. County Seat had its own personnel department and its own personnel policies and procedures. There were few transfers of employees between Super Valu and County Seat, although County Seat participated with Super Valu and its other subsidiaries in common retirement and employee stock ownership plans.

County Seat and Super Valu maintained their respective home offices at the same location. County Seat was charged an intercorporate fee for the cost of the office facilities occupied by it. Super Valu charged County Seat a portion of Super Valu's interest and expense attributed to the construction of the common facilities.

Super Valu contends that it exercised very little oversight of the operation of County Seat, and except that County Seat's capital and operating budgets were approved by Super Valu's board of directors, Super Valu did not conduct any formal oversight of County Seat or involve itself in any of County Seat's major business decisions. Super Valu concedes that its role in the budgeting process, however, affected the number of new County Seat stores that could be opened.

County Seat and Super Valu shared the services of several Super Valu departments, including cash management services, payroll, insurance services, legal services, tax preparation, auditing procedures, and corporate tax preparation. The costs of shared services were allocated among Super Valu and its other subsidiaries, including County Seat. Divisions of Super Valu provided architectural, engineering, and store design services for County Seat, which paid Super Valu for them.

Super Valu borrowed from outside sources the funds necessary to meet the needs of its subsidiaries, including County Seat. The borrowed funds were furnished to the subsidiaries, which then became indebted to Super Valu. Super Valu guaranteed some of County Seat's retail store leases on the request of the store owners, but Super Valu was never required to perform on any of these obligations.

The director of revenue found that County Seat was "totally dependent" on Super Valu for its initial financing and subsequent expansions; however, Super Valu contends that these findings were not supported by

substantial evidence. It contends that Super Valu used resources available to it to establish the County Seat business as a division of Super Valu in 1973 but that it was not totally responsible for furnishing the $22,900,000 in resources required to incorporate County Seat in 1976. In fact, Super Valu argues, County Seat had been operating for three years prior to the incorporation and furnished part, although it does not specify how much, of the $22,900,000 required for the incorporation. It does point out that County Seat's net operating earnings through its 1976 fiscal year were $8.2 million and $26.7 million through the fiscal year ending in 1977, which included the year of the incorporation.

While the extent of Super Valu's involvement in the financial affairs of County Seat was substantial, Super Valu contends it was not sufficient to constitute a unitary business relationship for tax purposes. It relies primarily on the dissimilarity of the businesses of Super Valu and County Seat and the lack of day-to-day control by Super Valu.

Under Iowa Code section 422.33, a tax is imposed on a corporation's net income as defined in section 422.35. If a taxpayer conducts business both within and without the state of Iowa, only that portion of its net income reasonably attributed to its income-producing activities in Iowa may be taxed. *American Home Prods. Corp. v. Iowa State Bd. of Tax Review*, 302 N.W.2d 140, 144 (Iowa 1981). Super Valu and the department agree that the pivotal issue in this case may be simply stated: whether Super Valu and County Seat were "unitary" businesses as that term is applied in tax cases. If they are unitary, the

capital gain on Super Valu's sale of County Seat is includable in part in Super Valu's Iowa income. If the businesses are not unitary, any gain on the sale would be included in Super Valu's return in the state of its domicile, Minnesota. The burden of establishing exclusion of income is on the taxpayer. *Richards v. Iowa Dep't of Revenue*, 360 N.W.2d 830, 831 (Iowa 1985) (assessment of income tax presumed to be correct; taxpayer has burden of proof of error).

Under the due process and commerce clauses of the United States Constitution, a state may not impose an income-based tax on "value earned outside its borders." *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 164, 103 S. Ct. 2933, 2939, 77 L. Ed. 2d 545, 552 (1983); *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315, 102 S. Ct. 3103, 3108, 73 L. Ed. 2d 787, 794 (1982). The Supreme Court, however, has noted the difficulty in arriving at precise territorial allocations of value in integrated business enterprises. *Container Corp.*, 463 U.S. at 164, 103 S. Ct. at 2939, 77 L. Ed. 2d at 552.

Under the Supreme Court test, a finding of a unitary relationship between business entities will be affirmed if such finding is "within the realm of permissible judgment." *Container Corp.*, 463 U.S. at 180, 103 S. Ct. at 2948, 77 L. Ed. 2d at 560. While our cases have not adopted such a test, we give deference to agencies in our review of their official actions. Judicial review of the action of the department of revenue is governed by our Administrative Procedure Act, Iowa Code §§ 17A.19(8), 422.55. *Nymann v. Department of Revenue & Fin.*, 465 N.W.2d 890, 891 (Iowa 1991).

Findings of fact by the agency are sufficient if they are supported by substantial evidence under the record as a whole. Iowa Code § 17A.19(8)(f); *Polk County v. Civil Rights Comm'n*, 468 N.W.2d 811, 815 (Iowa 1991); *Nymann*, 465 N.W.2d at 891.

We give weight to an agency's construction of a statute, although we are not bound by it. *Polk County v. Iowa Nat'l Resources Council*, 377 N.W.2d 236, 239 (Iowa 1985); *Woodbine Community Sch. Dist. v. Public Employment Relations Bd.*, 316 N.W.2d 862, 864 (Iowa 1982). We also give some weight to the department's interpretation and application of Supreme Court cases applying the unitary business concept although, again, we are not bound by it.

As *Container Corp.* noted, a state may constitutionally respect formal corporate lines and treat the ownership of a corporate subsidiary as per se a passive investment, thus not a component of a "unitary" business. *Id.* at 167-68, 103 S. Ct. at 2941, 77 L. Ed. 2d at 555. As the Court has noted, however, it is difficult to determine the income of a multistate taxpayer based on geographical or "transactional accounting." The problem is that "formal accounting is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." *Id.* at 164-65, 103 S. Ct. at 2940, 77 L. Ed. 2d at 553. Hence, the need for the "unitary business" concept.

> The unitary business/formula apportionment method is a very different approach to the problem of taxing businesses

> operating in more than one jurisdiction. It rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the "unitary business" of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that "unitary business" between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction.

Id. at 165, 103 S. Ct. at 2940, 77 L. Ed. 2d at 553.

Container Corp. recognized that the unitary business concept is not limited to vertically integrated businesses but may also include enterprises owned separately in different jurisdictions if they are linked together by common managerial or operational resources that produce "economies of scale and transfers of value." *Container Corp.*, 463 U.S. at 166, 103 S. Ct. at 2941, 77 L. Ed. 2d at 554 (citing *Butler Bros. v. McColgan*, 315 U.S. 501, 507, 62 S. Ct. 701, 704, 86 L. Ed. 991, 996(1942)).

Container Corp. also held that a substantial flow of goods between the two business entities need not be established to constitute a unitary business, concluding that "[t]he prerequisite to a constitutionally acceptable finding of unitary business is a flow of *value*, not a flow of goods." *Container Corp.*, 463 U.S. at 178, 103 S. Ct. at 2947, 77 L. Ed. 2d at 561.

> [A] relevant question in the unitary business inquiry is whether "'contributions to income [of the subsidiaries] result[ed] from functional integration, centralization of management, and economies of scale.'"

Container Corp., 463 U.S. at 179, 103 S. Ct. at 2947, 77 L. Ed. 2d at 562 (quoting *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354, 364, 102 S. Ct. 3128, 3135, 73 L. Ed. 2d 819, 827-28 (1982), quoting in turn, *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 438, 100 S. Ct. 1223, 1232, 63 L. Ed. 2d 510, 521 (1980)). While a substantial flow of goods is one factor to be considered, it is not the only one. *Container Corp.*, 463 U.S. at 179, 103 S. Ct. at 2947, 77 L. Ed. 2d at 562.

There is substantial support for the Department's conclusion that the Super Valu-County Seat relationship met the test for a unitary business. While day-to-day control of County Seat was not actually exercised by Super Valu, the power to do so was present. The directors of County Seat were also members of Super Valu's board of directors, Super Valu employees, or both. The original president of County Seat, William S. Bailey, was hired by Super Valu and later became a vice president of Super Valu, after serving as president of County Seat and a member of the board. Jack J. Crocker, former President and Chief Executive Officer of Super Valu, was a member of the board of directors of Super Valu, as well as a member of the board of directors of County Seat, until the time of County Seat's sale. James L. Slovick, Vice President and Treasurer of Super Valu, was also a member of the board of County Seat.

At the time County Seat was sold, its twelve officers included five executive officers of Super Valu. William S. Bailey, Vice President of Super Valu, was president of County Seat. C.D. Dugan, Vice President and Legal Secretary of Super Valu, was the Vice President and Secretary of County Seat. R.O. Erickson, Vice President for Market Development with Super Valu, was Treasurer of County Seat. J.B. Ferris, Senior Vice President of Super Valu, was Vice President and Assistant Treasurer of County Seat. William C. Hunt, Assistant Secretary of Super Valu was also Assistant Secretary of County Seat.

Super Valu's chief executive officer had the authority to hire and fire the president of County Seat, and the board of directors of Super Valu fixed the compensation of County Seat's president.

Life and disability insurance for County Seat employees was purchased by Super Valu for Super Valu's own employees, as well as its subsidiaries, including County Seat. County Seat employees also participated in a common retirement plan and employee stock ownership plan developed by Super Valu.

Super Valu conducted an annual review and approval of County Seat's operating and capital budgets that bore directly on the number of new stores that County Seat could open. Super Valu performed payroll processing and audit services for County Seat and filed the tax returns required of County Seat. Super Valu had a centralized cash concentration system that handled all cash management for Super Valu and its other subsidiaries, including County Seat. Income of all subsidiaries, and Super Valu, was pooled in the system

and used for the payment of expenses incurred by Super Valu and its subsidiaries.

The initial financing of County Seat was totally provided by Super Valu. A promissory note from County Seat to Super Valu for $22,900,343, representing a seven-year indebtedness was not paid within the time provided by the note. Yet, during the period of the note, County Seat expanded from eighty to 269 stores. A reasonable conclusion is that County Seat's success was a direct result of this financial nurturing by Super Valu.

Short-term borrowing and short-term investment decisions to provide working capital for the subsidiaries, including County Seat, was provided by Super Valu, which, as previously noted, borrowed money on behalf of County Seat. We believe there is evidence to establish that County Seat was largely dependent on Super Valu for its continued financing, although it probably could have existed financially on its own.

We conclude that the Super Valu-County Seat relationship produced the "economies of scale and transfers of value" inherent in a unitary business for tax purposes, *Container Corp.*, 463 U.S. at 166, 103 S. Ct. at 2941, 77 L. Ed. 2d at 554. A portion of Super Valu's gain on its sale of County Seat was therefore properly submitted to Iowa's income tax. Accordingly, we affirm.

AFFIRMED.

APPENDIX B

IN THE IOWA DISTRICT COURT FOR POLK COUNTY

SUPER VALU STORES, INC.
Petitioner,
vs.
DEPARTMENT OF REVENUE,
Respondent.[1]

CASE NO. AA 1571

September 21, 1990

Hearing on Petition for Judicial Review was held before this Court. The Court having read the transcript, file and briefs of the attorneys, and having heard arguments from John W. Windhorst, Jr., Petitioner's attorney, and Harry M. Griger, Respondent's attorney, finds as follows:

FINDINGS OF FACT

1. The Petitioner, Super Valu Stores Inc., sold a wholly owned subsidiary, County Seat. It allocated all the gain from the sale to the state of Minnesota, its commercial domicile, as nonbusiness income on its corporate income tax return for the taxable year 1985. The Respondent determined this gain was business

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[1] Typographic errors appearing in the text of the District Court opinion have been corrected.

income and assessed the Petitioner additional Iowa corporation income tax of Three Hundred Ninety Five Thousand Five Hundred Ninety Seven Dollars and Twenty Three Cents ($395,097.23) plus interest. On October 11, 1988 a hearing was held before the administrative law judge (ALJ). The ALJ in her Order dated November 20, 1980 ruled as follows:

> Contributions to the income of the subsidiary resulted from the functional integration, centralization of management and economies of scale between Super Valu and its subsidiary, County Seat. For that reason, Super Valu was engaged in a unitary business operation and is subject to Iowa taxation on an apportionment formula basis rather than on a separate accounting basis. Super Valu's capital gain on the sale of County Seat stock is part of Super Valu's apportionable business income. The Department's assessment is affirmed.

3. An appeal was taken by the Petitioner and on July 31, 1989 the Director issued his order affirming the Department's assessment and the ALJ's Order. The Director in his Order said at page 3

> The Director finds that the administrative law judge's findings and Conclusions are supported by substantial evidence in the record. The Director adopts the administrative law judge's Proposed Order except for the misstatements which the

> parties agree should be corrected and the revisions to conform to the supplemental stipulation to which the parties agree.
>
> The Statement of the Case in the Proposed Order is adopted by the Director with an added reference to the supplemental stipulation and affidavit. A reference to the supplemental stipulation and affidavit also is added to the first unnumbered paragraph under the heading Findings of Fact. The remaining paragraphs and the Findings of Fact have been numbered as well as renumbered. The amendments made to the Findings of Fact are explained as follows:

The Director affirmed the ALJ's decision and the Department's assessment. This Petition for Judicial Review followed.

4. This Court accepts the ALJ's findings of fact as amended by the Director and incorporates them in this Order as if set out in full herein.

CONCLUSIONS OF LAW

As stated on page 1 of the Petitioner's Reply Brief:

> The sole issue in this case is whether at the time the Super Valu Stores, Inc., (Super Valu) realized a capital gain upon the sale of all of its stock in County Seat Stores, Inc., (County Seat) on May 25, 1984, the two

> corporations were engaged in a "unitary business". If so, the Capital gain is business income subject to apportionment. If not, the capital gain is non business income allocable to Minnesota Super Valu's commercial domicile.

The Petitioner allocated the gain from the sale of its stock in County Seat to Minnesota, its commercial domicile, as a nonbusiness capital gain pursuant to Iowa Code § 422.33(2)(a)(4). The applicable part of that section states:

> Gain and losses from the sale or disposition of tangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

The Respondent claimed the gain to be business income subject to apportionment under Iowa Code § 422.33(2)(b). The Petitioner maintains that the capital gain from the sale of its County Seat stock is business income subject to apportionment only if County Seat was a part of Super Valu's unitary business. The Petitioner further maintains that County Seat was not a part of Super Valu's unitary business and that the gain was therefore properly allocated to Minnesota as nonbusiness capital gain. "The linchpin of apportionability in the field of state income taxation (of an interstate enterprise) is the unitary business principle." *Mobil Oil Corporation v. Commissioner of Taxes*, 100 S.Ct. 1223, 1232 (1980).

A number of state courts have described, adopted, applied and interpreted the unitary business principle.

Unfortunately, the Iowa Supreme Court is not one of them. Some of those state decisions have reached the United States Supreme Court. One of them is the case of *Container Corporation of America v. Franchise Tax Board*, 103 S.Ct. 2933 (1983). Both parties have cited this case since it is the most recent decision, on closely related facts, on the unitary issue decided by the United States Supreme Court. In that case Container Corporation of America (Container) was in the business of manufacturing custom ordered paper board packaging. It controlled twenty foreign subsidiaries in Latin America and Europe. All but two of the subsidiaries were in the same business as Container in their respective local markets. They were relatively autonomous concerning matters of personnel and day to day management. A Senior Vice-President and four other officers of Container supervised the subsidiaries and established "general standards of professionalism, profitability and ethical practices and dealt with major problems and long-term decisions". *Id.* at 2944. Container "had a number of directors and officers on the board of directors of the subsidiaries, but did not generally play an active role in the management decisions." *Id.* at 2944.[2]

As pointed out by the Director at page 24 in his Order of July 31, 1989, "The parallel between the facts in

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[2] The District Court's quotation of *Container* is inexact. The correct quotation is: "[Container] had a number of its directors and officers on the boards of directors of the subsidiaries, but they did not generally play an active role in management decisions." *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 172 (1983).

Container and those in this case is striking. In almost every respect Super Valu's operational relationship with County Seat was as close as or greatly exceeded that which existed between Container Corp. and its subsidiaries." The Director continued to compare the Container case with the case at hand on pages 24-26 of his Order and concluded by saying on page 26, "Each criterion suggested by the Supreme Court in Container, before a unitary business can be found, is met by the close operational relationship which existed between Super Valu and County Seat."

The Petitioner maintains that in order to have a unitary business the corporations must operate related businesses; if not the same business, they must at least be similar. The Petitioner cites Container for this proposition. Container, however, clearly points out that when the businesses are related or similar it is "but only as one element among many" when concluding if the businesses are unitary. *Id.* at 2947.

The Respondent in its brief filed March 13, 1990, cited nine state court cases that rejected Super Valu's position that unitary businesses only exist where they are from the same or similar business or those involved in related steps in a common process. In the Container case, *id.* at page 2947, the Court said, "The prerequisite to a constitutionally accepted finding of unitary business is a flow of value, not a flow of goods."

The taxpayer has the burden to show that the Department assessment was erroneous. *Richards v. Iowa Dept. of Revenue*, 360 N.W. 2d 830, 831 (Iowa 1985). "The general rule, applicable here, is that a taxpayer claiming

immunity from a tax has the burden of establishing his exemption. Container, *id.* at 2945. The Petitioner has not met its burden.

There is substantial evidence to support the Department's decision. The Department has correctly applied the applicable law. The Department's ruling should be sustained.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that the decision of the Department of Revenue and Finance is **AFFIRMED**. The Petitioner shall pay the costs of this action.

Dated this 21st day of September, 1990.

JACK D. LEVIN, JUDGE
FIFTH JUDICIAL DISTRICT

APPENDIX C

BEFORE THE IOWA STATE DEPARTMENT OF REVENUE AND FINANCE

IN THE MATTER OF SUPER VALU STORES, INC.

DOCKET NO. 86-510-2A-A

July 31, 1989

On December 29, 1988, Super Valu Stores, Inc. (Protestor) filed an appeal to the Director of the Iowa Department of Revenue and Finance (Director) from a Proposed Order issued by an administrative law judge on November 29, 1988. On January 5, 1989, the Director issued a notice, setting a review of the Proposed Order for February 14, 1989. On February 8, 1989, the Protestor submitted an amendment to appeal to Director. The Protestor also submitted a request for continuance of the Director's review and a request for receipt of additional evidence (a supplemental stipulation). The Department of Revenue and Finance (Department) did not resist the requests. On February 8, 1989, the Department filed a response to the appeal and amendment to appeal. On February 24, 1989, the Protestor filed a reply to the Department's response.

On February 15, 1989, the Director issued a continuance order, continuing the review to February 28, 1989. The Director also admitted the supplemental

stipulation into the record pursuant to the parties' agreement as stated in the supplemental stipulation.

On February 20, 1989, the Protestor filed a request to attend the Director's review on February 28. The request was granted. On February 28, 1989, John W. Windhorst, Jr., Protestor's attorney, and Harry M. Griger, Department's attorney, presented oral arguments to the Director. On March 17, 1989, the Protestor filed an affidavit pursuant to an agreement made at the oral arguments. The affidavit is admitted into the record. On May 16 and June 15, 1989, the Director issued extension orders, extending the time for issuance of his decision.

The supplemental stipulation (10 pages) which was filed after the appeal covers the ownership of the two distribution centers and the extent to which County Seat was current in its payment of note interest and other intercompany liabilities. The affidavit (3 pages) which was filed after oral arguments to the Director is an affidavit of Frank J. O'Keefe, Director of Taxes for the Protestor. The affidavit covers the following: the amount of net interest expense charged to County Seat during fiscal years 1982 and 1983 under the CCU System; a statement of the pretax net operating earnings of the County Seat business for each of the fiscal years from 1974 through 1984; and the treatment of County Seat on the Protestor's Iowa tax returns during the period that County Seat operated as a division of the Protestor.

In its appeal the Protestor requested reversal of the Proposed Order, contending that the administrative law judge erred in the legal conclusion that County Seat was part of the Protestor's unitary business at the time of

the sale of the County Seat stock and that therefore the Protestor's gain on the sale was business income subject to apportionment. The Protestor also contended the following regarding the findings of fact: some of the findings are not warranted in light of the evidence in the record; the findings are incomplete in that many of the facts in the record relevant to the issue in the case are not set forth in the findings; and some of the findings must be amended to reflect the additional evidence contained in the supplemental stipulation.

In its response to the appeal the Department contended that any revisions to the Proposed Order should be limited only to correction of misstatements of the record and to revisions to conform to the supplemental stipulation. The Department argued that the Protestor's other proffered amendments were argumentative, proffered in an attempt to justify interferences that were not consistent with substantial evidence in the record, and unnecessary to add to the Proposed Order which is supported by substantial evidence.

The Director finds that the administrative law judge's findings and conclusions are supported by substantial evidence in the record. The Director adopts the administrative law judge's Proposed Order except for the misstatements which the parties agree should be corrected and the revisions to conform to the supplemental stipulation to which the parties agree.

The Statement of the Case in the Proposed Order is adopted by the Director with an added reference to the supplemental stipulation and affidavit. A reference to the supplemental stipulation and affidavit also is added

to the first unnumbered paragraph under the heading Findings of Fact. The remaining paragraphs in the Findings of Fact have been numbered as well as renumbered. The amendments made to the Findings of Fact are explained as follows:

(1) in the second full paragraph on page 3 of the Proposed Order (now Finding of Fact number 3) the word "Super Valu" was replaced by "County Seat's directors" to describe who appointed Wm. Bailey as president of County Seat. The Department agreed that this was superficially correct but also noted that the County Seat's board of directors wholly consisted of Super Valu board members (in Finding of Fact number 3) and that Super Valu's chief executive officer could hire or fire County Seat's president (in Finding of Fact 7b);

(2) the last paragraph on page 3 of the Proposed Order regarding interest on the note was deleted because the matter was covered in a later finding (Finding of Fact 7k);

(3) the words "warehouse, transportation, or other" were added to the numbered paragraph 6 on page 5 of the Proposed Order (now Finding of Fact 6f);

(4) in numbered paragraph 2 on pages 5 and 6 of the Proposed Order the words "about half" were replaced by "five"; the office of Vice-Pres. for Wm. C. Hunt was deleted; and the name Michael W. Wright and the offices with that name were deleted (now Finding of Fact 7b);

(5) numbered paragraph 3 on page 6 of the Proposed Order was deleted and replaced with Finding of Fact 7c. This change was a result of the supplemental stipulation;

(6) the following sentences were added to numbered paragraph 5 on page 6 of the Proposed Order:

> Super Valu was never called upon to satisfy any of County Seat's obligations. There is no evidence that Super Valu ever refused to furnish the guaranty.

(now Finding of Fact 7e);

(7) in numbered paragraph 8 on page 7 of the Proposed Order the word "usually" was added to the third sentence after the words "Super Valu" (now Finding of Fact 7h);

(8) the last sentence of numbered paragraph 10 on pages 7 and 8 of the Proposed Order was amended to read as follows: "[F]rom August 1976 through February 1981, County Seat was charged interest on the unpaid note at the rate of 9.5% per annum." This change (now Finding of Fact 7j) was a result of the supplemental stipulation; and

(9) numbered paragraph 11 on page 8 of the Proposed Order was deleted and replaced with Finding of Fact 7k. This change was a result of the supplemental stipulation.

The only amendments in the Conclusions of Law were the following deletions on page 25 of the Proposed Order: the deletion of the words "at least" in the third

line of the page (regarding the number of Super Valu executive officers who were County Seat officers at the time of the sale); and in the second full paragraph the deletion of the following phrase: "[A]dditionally, County Seat did not pay interest on the loan of $22,900,343 made by Super Valu to County Seat; and".

The Director, having examined the record developed by the parties, hereby issues this order.

STATEMENT OF THE CASE

The Iowa Department of Revenue and Finance (Department) ultimately determined deficiencies in Super Valu Stores, Inc.'s (Protestor) Iowa corporate income tax of $395,597.23 plus interest thereon for the taxable year of 1985. In its Iowa income tax return filed for that year, Protestor allocated a long term gain of $41,067,700 on the 1984 sale of wholly-owned subsidiary, County Seat Stores, Inc. (County Seat) to Minnesota (Protestor's commercial domicile) as nonunitary, nonbusiness capital gain.

On audit, the Department classified the gain as business income subject to apportionment; and subsequently issued a Notice of Assessment of tax, penalty and interest for the taxable year ending on February 23, 1985. Super Valu Stores, Inc. filed a Protest on or about November 17, 1986, objecting to the determination that the capital gain realized on the sale of the stock of County Seat is includable in its apportionable income. The Department filed its Answer on August 28, 1987, denying Protestor's legal assertions; and contending that Protestor and County Seat were engaged in a unitary business.

On September 16, 1987, a notice was issued scheduling an evidentiary hearing for December 1, 1987; and orders continuing the hearing were subsequently issued with the last such order rescheduling the hearing for March 15, 1988.

On March 14, 1988, the parties filed a stipulation indicating that they were submitting an offering of evidence in lieu of testimony.

The parties, through their authorized representatives (John W. Windhorst, Jr., Attorney at Law for the Protestor and Harry M. Griger, Special Assistant Attorney General for the Department) submitted briefs in accordance with a schedule agreed upon by the parties, and thereafter extended at the parties' request. Oral arguments were presented on October 11, 1988; and this matter was deemed submitted to the administrative law judge for a decision on that date.

In their stipulation the parties agreed that the statements of both parties could be received into evidence without objection other than to the relevance and materiality, with objections to be made on the brief. The objections of both parties to the relevancy and materiality of various statements and exhibits of the other party were overruled; objections to legal conclusions made by the other party in the stipulation and exhibits were sustained by the administrative law judge. Iowa Code § 17A.14(1). Protestor's Exhibits 1 through 7, and Department's Exhibits A through F were tendered and admitted into evidence, subject to the foregoing ruling. A supplemental stipulation and affidavit were admitted into the record by the Director.

FINDINGS OF FACT

The parties agreed to forego oral presentation of evidence in this case; and to submit the matter for decision on the basis of the individual offering of evidence submitted in their joint stipulation. Protestor offered as evidence in the stipulation, 7 exhibits and 75 statements, indicating that the statements reflected the substance of anticipated testimony of personnel of Super Valu, were they called as witnesses. The Department offered all or parts of 6 exhibits. Based on those statements and exhibits offered as evidence in the stipulation, and thereafter urged as statements of fact by both the Protestor and the Department in their briefs and oral arguments, and the supplemental stipulation and affidavit, the undersigned makes the following findings of fact.

1. The Protestor, Super Valu Stores, Inc. (Super Valu), is a corporation; and its principal place of business and commercial domicile is located in Minnesota. During the tax year under consideration (taxable year ending on February 23, 1985), Super Valu sold food and other grocery store items at wholesale to independently owned supermarkets in approximately 28 states, including Iowa. Super Valu also owned 26 subsidiaries, 24 of which were engaged in the wholesale food business or providing services to that business. The other 2 subsidiaries were County Seat Stores, Inc. (County Seat) which operated specialty retail clothing stores, and Shopko Stores, Inc. which conducted a retail general merchandising business.

2. During the taxable year, Super Valu operated a wholesale warehouse and 2 company owned

(subsidiary) retail grocery stores in Iowa; and County Seat operated 10 retail clothing stores in Iowa.

3. County Seat was initially established as a division of Super Valu in 1973. After substantial growth from 1 to 80 stores, County Seat was incorporated in March 1976. The three members of County Seat's board of directors were on Super Valu's board. Wm. Bailey, who was appointed County Seat's president by County Seat's directors, was a vice-president of Super Valu. In August 1976, Super Valu transferred to County Seat Division, assets having a fair market value of $23,900,343. As payment for the transfer of these assets, approximately $1,000,000 was treated as paid-in capital; and County Seat issued a seven-year promissory note to Super Valu in the principal amount of $22,900,343 bearing interest at the rate of 9.5%.

4. Upon County Seat's incorporation, Super Valu assigned all outstanding contracts (which had been executed by Super Valu when County Seat was an unincorporated division) to County Seat. Thereafter, County Seat executed contracts in its own name.

5. Super Valu sold all its stock in County Seat on May 25, 1984, and realized a long-term capital gain of $41,067,700 on the sale. In its Iowa income tax return filed for the taxable year, Super Valu allocated this gain to Minnesota as a nonbusiness capital gain. On audit, the Department classified the gain as business income subject to apportionment in accordance with Super Valu's business activity ratio; and determined that Super Valu owed additional tax of $478,959 plus interest for the taxable period. The Protestor conceded that it owed

additional tax of $156,286 plus interest. The Department subsequently received a partial payment. Currently the amount in dispute is $395,597.23 plus interest.

6. IN VARIOUS RESPECTS, SUPER VALU AND COUNTY SEAT WERE AUTONOMOUS

6a. Super Valu and County Seat had separate organizational structures. County Seat neither purchased from nor sold to Super Valu and its subsidiaries, any inventory or equipment. Super Valu and its subsidiaries, did not purchase any inventories, supplies or equipment for County Seat. Super Valu had no purchasing policies applicable to County Seat. County Seat and Super Valu had separate product distribution systems and warehouses.

6b. County Seat was in the specialty retail clothing business, selling blue jeans and other fashion clothing items. The products sold by County Seat were entirely different from the food and other grocery store products and services sold by Super Valu and its other subsidiaries in the wholesale food business or businesses related thereto.

6c. County Seat and Super Valu did not share brand names, logos, packaging systems, patents, copyrights, trademarks, slogans, or customer lists; nor did they have a uniform credit card system; nor did they honor the others product warranties, guarantees, or customer complaints.

6d. County Seat's advertising activities were separate from those of Super Valu. Similarly, neither

entity performed research and product development services for the other.

6e. Super Valu personnel did not work or otherwise actually operate any of the County Seat stores to the extent that they were physically present at the stores. County Seat had its own personnel department and developed its own personnel policies. None of County Seat's employees were unionized; and about 60% of Super Valu's hourly employees were unionized when County Seat stock was sold. Neither Super Valu nor County Seat rotated or trained its employees with or for the other.

6f. Super Valu and County Seat did not share any retail or office, warehouse, transportation, or other business locations except for home office facilities; and Super Valu did not actually find or locate any store sites for County Seat.

6g. Super Valu never pledged its interest in County Seat to borrow money and never received dividend income from County Seat.

7. **NEVERTHELESS, THE MANAGERIAL AND FINANCIAL RELATIONSHIPS BETWEEN SUPER VALU AND COUNTY SEAT WERE SUBSTANTIALLY INTERWOVEN**

7a. Super Valu and County Seat had their principal business locations at the same place, 11840 Valley View Road, Eden Prairie, Minnesota. Super Valu charged County Seat a fee for the use of these facilities; but the fee was less than if County Seat had leased office space from a third party.

7b. The initial Board of Directors and all subsequent County Seat board members, were also members of Super Valu's Board of Directors and/or employees of Super Valu, including:

NAME	OFFICE-SUPER VALU	OFFICE COUNTY SEAT
Jack J. Crocker	Pres., Chief exec. ofc. til 1982; member of the board till time of sale	member of board
Wm. S. Bailey	Hired by Super Valu as General Manager of County Seat; later became Vice-Pres. of Super Valu	President of County Seat, member of board
James L. Slovick	Vice Pres.; Treas.	member of board

At the time of the sale of the County Seat stock, County Seat had twelve officers, five of whom were executive officers of Super Valu including:

NAME	OFFICE-SUPER VALU	OFFICE COUNTY SEAT
Wm. S. Bailey	Vice Pres.	Pres.
C. D. Dugan	Vice Pres. Legal Sect'y.	Vice Pres. Sect'y.
R. O. Erickson	Vice Pres. (Market Devp't)	Treasurer
J. B. Ferris	Senior Vice Pres.	Vice Pres., Asst. Treas.
Wm. C. Hunt	Asst. Sect'y.	Asst. Sect'y.

All of the foregoing persons who served as corporate officers for both Super Valu and County Seat executed financial and legal documents (such as tax returns) on behalf of County Seat; and all were compensated by Super Valu. Stip. A-10. Super Valu's chief executive officer had the authority to hire or fire the president of County Seat. The Board of Directors of Super Valu fixed the compensation of County Seat's president.

7c. County Seat served all of its retail stores out of two distribution centers, which County Seat used exclusively. One of the distribution centers was an 86,000 square foot facility in Dallas, Texas. The other was a 150,000 square foot facility in Brooklyn Park, Minnesota.

County Seat held title to and bore the cost of the Dallas facility, which was placed in service in its fiscal year ending in 1978. To the extent that funds of or borrowed by Super Valu were used to fund this cost, a charge would have been made to County Seat's intercompany account. County Seat was charged or credited with interest on its intercompany account balance at the rate of 9.5% per annum up to the end of the fiscal year ending in 1981. Thereafter, County Seat was charged or credited with interest on its intercompany account balance through the Capital Contribution/Usage System (CCU System) described in paragraphs A-23 to A-26 of the stipulation.

Super Valu held title to the Brooklyn Park facility, but County Seat bore the cost of the facility, which was placed in service in its fiscal year ending in 1982. Funds of or borrowed by Super Valu were used to

fund the cost, but the amount paid (including the $1,000,000 in industrial revenue bonds described in paragraph A-28 of the stipulation) was charged to County Seat's intercompany account. In addition, the cost of the distribution facility was reflected in the "capital employed" by County Seat (as described in paragraph A-24 of the stipulation). Therefore, County Seat paid interest on this cost through the CCU System. Super Valu transferred title to the Brooklyn Park facility to County Seat when Super Valu sold the County Seat stock.

7d. Super Valu purchased life and disability insurance for County Seat employees as well as for employees of the other Super Valu subsidiaries. County Seat employees participated in common employee benefit programs with employees of Super Valu. Super Valu developed, filed with appropriate government agencies, and administered, a common retirement plan and employee stock ownership.

If an insurance claim against County Seat exceeded $10,000, Super Valu had the final authority to decide whether or not to settle the claim.

7e. From time to time, at the request of landlords entering into retail store leases with County Seat, Super Valu furnished a guarantee of County Seat's obligations as a tenant under the lease. Super Valu was never called upon to satisfy any of County Seat's obligations. There is no evidence that Super Valu ever refused to furnish the guaranty.

Super Valu conducted an annual review and approval of County Seat's operating and capital budgets.

Such review affected the number of new stores that County Seat could open. Super Valu performed marketing services for County Seat consisting of the preparation of appropriate sales volume projections in areas where County Seat was considering opening stores. County Seat was charged an intercorporate allocation for said services on a time and expense basis.

7f. Super Valu performed common payroll processing and audit services for County Seat. Also, Super Valu compiled and filed on behalf of County Seat, various tax forms and provided tax planning services. No profit was made by Super Valu on any charges for these services.

7g. Super Valu's financial services department, through a centralized cash concentration system handled all cash management for Super Valu and other subsidiaries, including County Seat. The funds of all subsidiaries and Super Valu were used by Super Valu to pay the bills and expenses of its subsidiaries and itself. If short-term borrowing or short-term investment were needed to provide working capital for Super Valu or any of its subsidiaries, including County Seat, Super Valu engaged in such borrowing from financial institutions. While Super Valu charged for these services, no profit was charged by Super Valu and the fee was lower than a comparable fee if the services had been performed by an unrelated third person.

7h. Super Valu's in house legal department performed legal services for County Seat for which County Seat was charged an intercorporate allocation. County Seat's hiring and utilization of outside counsel

ordinarily was initiated and monitored by Super Valu's in-house legal department. The outside counsel retained was frequently the same outside counsel that Super Valu usually retained for itself. Super Valu arranged for or recommended separate representation for County Seat as needed.

7i. Two divisions of Super Valu performed architectural, engineering and store interior design services for County Seat. County Seat was charged for such services at a rate charged to unrelated customers.

7j. County Seat was totally dependent upon Super Valu for its initial financing, and for its subsequent expansion. County Seat did not expend its own resources on its creation and it received a substantial subsidy from Super Valu which guaranteed that County Seat would be in business regardless of its profits or losses, as long as Super Valu was willing to subsidize County Seat from Super Valu's food business. The $22,900,343 seven-year note was not paid within the seven-year period; yet, during this period, County Seat was able to expand from 80 to 269 stores when sold. From August 1976, through February 1981, County Seat was charged interest on the unpaid note at the rate of 9.5% per annum.

7k. From August 1976, through February 1981, County Seat also was charged (or credited with) interest at the rate of 9.5% on its intercompany account balance. County Seat's intercompany account balance reflected all transfers of cash between Super Valu and County Seat, note interest, charges for services performed by Super Valu departments, and interest charged or credited on the intercompany account balance. Commencing in

March 1981, interest on the note and on the intercompany account balance was charged to County Seat through the Capital Contribution/Usage System (CCU System) described in paragraphs A-23 to -26 of the stipulation.

County Seat paid its obligations to Super Valu, including note interest, other intercompany interest, and service charges, in accounting periods in which its transfers of cash to Super Valu's concentration bank account exceeded its expenses, because County Seat's intercompany account balance was reduced to the extent of such excess. This occurred in many accounting periods. In several accounting periods, County Seat's intercompany account balance was positive (i.e., a receivable owing from Super Valu), indicating that County Seat had satisfied all previously-incurred obligations to Super Valu. The facts set forth in the following paragraph demonstrate that County Seat paid its obligations to Super Valu quite close in time to when they were incurred, most often in the same fiscal year in which they were incurred.

By the end of its fiscal year ending in 1977, County Seat had paid the note interest for such fiscal year, all service charges made at or before the end of such fiscal year, and all interest charged at or before then on its intercompany account balance. By the end of the second-to-last accounting period of its fiscal year ending in 1979, County Seat had paid the note interest for its fiscal year ending in 1978 and all service charges and interest charged on its intercompany account balance since the end of its fiscal year ending in 1977. By the third-to-last accounting period of its fiscal year ending in 1980, County Seat paid the note interest for its fiscal year ending in 1979 (other

than erroneous interest charged in 1980 for 1979) and all service charges and interest charged on its intercompany account balance since the second-to-last accounting period of its fiscal year ending in 1979. By the end of its fiscal year ending in 1980, County Seat paid the note interest for such fiscal year (other than erroneous interest charged in 1980 for such fiscal year) and all service charges and interest charged on its intercompany account balance since the third-to-last accounting period of its fiscal year ending in 1980. By the end of its fiscal year ending in 1981, County Seat paid the note interest for such fiscal year and all service charges and interest charged on its intercompany account balance since the end of its fiscal year ending in 1980. (County Seat's stated intercompany account balance at the end of its fiscal year ending in 1981 showed a net liability of $1,984,978, but such balance reflected erroneous interest charges for 1979 and 1980 in excess of $3,600,000. Without the erroneous interest charges, County Seat's intercompany account balance at the end of its fiscal year ending in 1981 would have been a net receivable of in excess of $1,615,022.) By the end of its fiscal year ending in 1982, County Seat paid all service charges and interest charged through the CCU System (including note interest for its fiscal year ending in 1982) since the end of its fiscal year ending in 1981. By the end of its fiscal year ending in 1983, County Seat paid all service charges and interest charged through the CCU System (including note interest for its fiscal year ending in 1983) since the end of its fiscal year ending in 1982.

In or around August 1983, the due date of the note, the note was cancelled and a charge of $22,900,343

(the principal amount of the note) was made to County Seat's intercompany account. Interest was charged on County Seat's intercompany account balance through the CCU System so County Seat was always charged interest on any unpaid principal under the note. County Seat's intercompany account balance by February 1984, the end of the fiscal year in which this $22,900,343 charge was made, was a negative balance of only approximately $4,900,000, and this negative balance reflected in excess of $3,600,000 in erroneous interest charges, so County Seat effectively had paid at least $21,600,343 of the note within six months of the due date of the note. County Seat's intercompany account balance at the time of the sale of the County Seat stock in May 1984 was a negative balance of $5,787,560, which reflected in excess of $3,600,000 in erroneous interest charges and was satisfied in full at the time of the sale.

71. Super Valu, in its financial and corporate reports, considered County Seat to be part of its trade or business. Exh. D

CONCLUSIONS OF LAW

This case concerns the proper treatment under Iowa law of Super Valu's capital gain on the sale of the County Seat stock. The issue is whether the capital gain is part of Super Valu's apportionable business income; or whether it is non-business income wholly allocable to Super Valu's commercial domicile in Minnesota.

Iowa Code § 422.33 imposes a corporate income tax upon Iowa corporations and foreign corporations doing business in Iowa; subsection 422.33(2)(a) provides that if the business of the corporation is carried on both within and partly without the state, the tax shall be imposed only on the portion of the net income reasonably attributable to the intrastate business, with nonbusiness capital gains from the sale of assets to be allocable to this state if the property had a situs in this state. Iowa Code subsection 422.33(4)(b)(4) provides that the remaining net business income of the taxpayer shall be allocated and apportioned; and that, where income is derived from the sale of tangible personal property, the part attributable to business within the state shall be in that proportion which the gross sales made within the state bear to the total gross sales. The Iowa statute is an apportionment or formulary method under which the measure of a tax is divided by a formula on the use of selected factors for weighting attribution to the states involved; and the "unitary business" doctrine underlies the use of formulary apportionment. As was stated in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980), "[T]he 'linchpin of apportionability' for state income taxation of an interstate enterprise is the 'unitary

business principle'". If the business is not unitary, a separate accounting method is typically utilized.[1]

It has long been established that the income of a business operating in interstate commerce is not immune from fairly apportioned state taxation. *Northwestern State Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458-462, 3 L.Ed.2d 421, 79 S.Ct. 367, 67 A.L.R.2 1292 (1959). "The entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs". *Northwestern States*, 358 U.S. at 460. For a state to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: a "minimal connection" between the interstate activities and the taxing state, and the rational relationship between the state and the intrastate values of the enterprise. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272, 57 L.Ed.2d 197, 98 S.Ct. 2340 (1978).

Protestor does not contest these general principles. What Protestor does seek to establish is that Super Valu and County Seat were not a part of the same "unitary business"; and that in the absence of the underlying unitary business, apportionment of Super Valu's multi-state business income is precluded. The general rule, applicable here, is that a taxpayer claiming immunity from a tax has the burden of establishing his exemption. *Kartridg Pak Co. v. Iowa Department of Revenue*, 362 N.W.2d 557, 561 (Iowa 1985).

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1 *See Butler Bros. v. McColgan*, 17 Cal.2d 664, 111 P.2d 334 (1941).

UNITARY BUSINESS PRINCIPLE

State Court Tests

Various state courts have summarized the various formulations of the unitary business principle. California pioneered in developing the "three unities test", set out in *Butler Bros. v. McColgan*, 17 Cal.2d 664, 111 P.2d 334 (1941), aff'd 315 U.S. 501.

> [I]t is our opinion that the unitary nature of appellant's business is definitely established by the presence of the following circumstances: (l) Unity of ownership; (2) Unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) Unity of use in its centralized executive force and general systems of operation.

The second test indicated by the state courts was the "contribution and dependency" test, which was added to the "three unities" test in *Edison California Stores v. McColgan*, 30 Cal.2d 472, 183 P.2d 16 (1947). It was stated in the following terms:

> If the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary. . . .

In recent years, there has been increasing acceptance of the view, not only by courts but among business groups, that a substantial flow of raw materials, products, or goods between the segments of a producing-

selling or manufacturing-selling enterprise, or mercantile business carried on in more than one state, is an essential characteristic of a unitary business. The General Accounting Office in a report issued in 1982, reported that corporate officials regard the "substantial interdependency test" as the primary criterion for the existence of a unitary business.[2] This test has been expressed as the "operational interdependency" test; and disregards central management, financing, advertising and other nonoperational relationships.[3]

The unitary principle was extended to business lacking interdependence of operations, or a flow of products, in two California cases, *Superior Oil*[4] and *Honolulu Oil*[5], in which segments of an oil producing business conducted in different states were found to be unitary, even though there was no flow of products between the states. In these cases the court found an interdependence of financing (or "flow of value"). The California court appears to have subsequently reversed

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2 General Accounting Office, Report to the Chairman of the House Ways and Means Committee, "Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving" 30 (GAO/GGD-82-38, July 1, 1982).

3 Hellerstein, "Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business", 21 Nat.Tax.J. 487 (1968).

4 *Superior Oil Co. v. Franchise Tax Bd.*, 60 Cal.2d 406, 386 P.2d 33, 34 Cal. Rptr. 545 (1963).

5 *Honolulu Oil Corp. v. Franchise Tax. Bd.*, 60 Cal.2d 417, 386 P.2d 40, 34 Cal. Rptr. 552 (1963).

itself in *Chase Brass & Copper Co.*[6], holding that a flow of raw materials or manufactured goods was a sine qua non to a finding that the segments of the business are unitary; and that centralized management and control do not, per se, establish the unity of use requisite to a unitary business.

However, in the more recent case of *Container Corp. of America,*[7] the same division of the California Court of Appeal was frontally presented with the issue and rejected the taxpayer's contention that "the substantial flow of goods is essential to the existence of a unitary manufacturing or mercantile business. . . ."

Supreme Court Tests

Beginning with the *Mobil Oil* case in 1980, the Supreme Court handed down a series of decisions under the Due Process Clause delimiting the scope of the unitary business for state tax apportionment purposes. In the *Mobil Oil* case, the Court declared that what the taxpayer must show in order to establish that its dividend income was not includable in the apportionable base of the Vermont tax, is that "the income was earned in the course of activities unrelated to the sale of petroleum products in that State", the only business that had been conducted by Mobil in Vermont. The Court also

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[6] *Chase Brass & Copper Co. v. Franchise Tax Bd.*, 7 Cal.App.3d 99, 105, 86 Cal. Rptr. 350, 353 (1st Dist. Ct. App.) (1970).

[7] *Container Corp. of America v Franchise Tax Bd.*, 117 Cal.App.3d 988, 173 Cal. Rptr. 121 (1st Dist. Ct. App. 1981); affirmed 463 U.S. 159, 77 L.E.2d 545, 103 S.Ct. 2933 (1983).

contrasted "a discrete business enterprise", which is not part of the unitary business, with "activities [that] are part of appellant's integrated petroleum enterprise", or its "functionally integrated enterprise", which the Court treated as unitary. Or put another way, a multistate enterprise may be characterized as a unitary business where there are "contributions to income resulting from functional integration, centralization of management, and economies of scale". *Mobil Oil, supra,* 445 U.S. at 438. Where these characteristics exist, use of a separate geographic accounting system may fail to account for these contributions to income, and an apportionment formula may then be used.

In decisions that followed *Mobil Oil,* the Court has used neither the "three unities" test nor the "contributions and dependency" test. Instead the Court has held that the existence of unity is evidenced by (l) functionally integrated activities; (2) economies of scale; and (3) centralized management.[8]

Activities that are vertically integrated or are in the same line of business fall well within the scope of the unitary business concept. Vertically integrated activities involve the various progressive steps of a business that are necessary to make a product available to market.[9] An

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[8] *See Exxon Corp. v. Wisconsin Department of Revenue,* 447 U.S. 207 (1980); *F. W. Woolworth Co. v. Taxation & Rev. Dept.,* 458 U.S. 354, 73 L.Ed.2d 819, 102 S.Ct. 3128 (1982).

[9] J. Hellerstein, State Taxation: Corporate Income and Franchise Taxes 330 (1983) at 443. *See Chase Brass & Copper. Co.,* note 6 (extraction, smelting, and refining copper.)

example of the "same line of business" concept is the various activities in the operation of a nationwide chain of retail furniture stores.[10]

Diverse corporate activities are those activities that are neither vertically integrated nor in the same line of business: this is the case presented by Super Valu, a retail grocery chain, and County Seat, a retail clothing chain.

When multi-jurisdictional corporate activities are diverse, as is the case with Super Valu, the characterization of the activities as either unitary or non-unitary is difficult. The question of what constitutes a unitary business depends on the particular facts of each case; but the basic issue, it has been said, is whether an interdependency exists between the various segments of the business enterprise so that the profits attributable to the taxing state cannot be ascertained correctly by "separate accounting" because the in-state business activities are too closely associated in an operational or economic sense with business activities without the taxing state.[11] Some cases have adopted an accounting feasibility test of a unitary business under which, if the books and records

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[10] *See Butler Bros. v. McColgan*, 315 U.S. 501 (1942) (seven wholesale houses operated out of a central distributing center).

[11] The Urban Lawyer, Vol. 10, No. 2 Spring 1978, Unitary Concept In State Income Taxation, p. 204.

of the taxpayer are adequate to the making of a separate accounting, apportionment is not to be employed.[12]

STATE VIEWS OF UNITARY BUSINESS REJECTED BY SUPREME COURT - *ASARCO, WOOLWORTH, CONTAINER* CASES

Before the 1981 term of the Supreme Court of the United States, the states generally had been fortunate in formulary apportionment cases, when challenged on constitutional grounds.[13]

The states received a setback in taxation of apportioned corporate income in two 1982 cases, *ASARCO*[14] and *Woolworth*[15], that stated the rule that "actual control" is a requisite of a unitary business.

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12 *Gulf Oil Corp. v. Clayton*, 267 N.C. 15, 147 S.E.2d 522, 528 (1966). *Square D. Co. v. Kentucky Bd of Tax Appeals*, 415 S.W.2d 594 (Ky. 1967). This general view was adopted in *Standard Oil Co. v. Wisconsin Tax Comm'n*, 197 Wis. 630, 223 N.W. 85 (1929), but it no longer prevails in Wisconsin, since that state has adopted the UDITPA (Uniform Division of Income for Tax Purposes). See also *Fisher v. Standard Oil Co.*, 12 F.2d 744 (8th Circuit 1926) but this case has since been overruled by the current North Dakota statute.

13 *See, e.g., Moorman Mfg. Co., supra.*

14 *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 102 S.Ct. 3103 (1982).

15 *F. W. Woolworth Co. v. Taxation & Revenue Department*, 458 U.S. 354, 102 S.Ct. 3128 (1982).

In the *ASARCO* case, the Idaho State Tax Commission sought to include within the taxable income of a non-domiciliary parent corporation, doing business in Idaho, a portion of intangible income - such as dividend and interest payments, as well as capital gains from the sale of stock - that the parent receives from subsidiary corporations having no other connection with the state. The United States Supreme Court held that Idaho's attempt to tax the interest and capital gains income derived from its subsidiaries violates the Due Process Clause; that no unitary relationship between ASARCO and its subsidiaries existed; and that while the dividend-paying subsidiaries "add to the riches" of ASARCO, they are "discrete business enterprises" that in any business or economic sense" have nothing to do with the activities of ASARCO.

A significant aspect of *ASARCO* is the Court's conclusion that ASARCO had produced evidence which convinced the trial Court that ASARCO and its subsidiaries were not a unitary business. The Court articulated the principle that actual exercise of control of a subsidiary, as distinguished from the legal right to control the company, is a sine qua non of a unitary business relationship; and found that, although ASARCO had the potential to control and manage its subsidiary, no claim was made that it had done so. (Like County Seat, the ASARCO subsidiary staffed the company with the subsidiaries own people; unlike County Seat/Super Valu, ASARCO never elected a director to the Board and it never selected officers.) The trial court found that the subsidiary of ASARCO operated entirely independently of, and had minimal contact with, ASARCO.

In the *Woolworth* case, the taxpayer-parent company (Woolworth), whose principal place of business and commercial domicile were in New York, was engaged directly in a retail business, through chains of stores located in the United States and territories. It also owned the capital stock of foreign subsidiaries, one located and operating in each of the countries of Germany, Canada, and Mexico, and slightly more than half the capital stock of a subsidiary located and operating in England. Each of the foreign subsidiaries, like Woolworth, was engaged in chain store retailing. The dividends paid by the four foreign subsidiaries had been includable in the New Mexico apportionable tax base; that inclusion was at issue.

The New Mexico Supreme Court had found that "control over the subsidiaries [by Woolworth]" was one of the factors that "point[s] to functional integration and reveal[s] an underlying unitary business for our purposes here."[16] The Supreme Court responded to this conclusion by referring to its holding in *ASARCO* that "actual exercise of control" is the test. The Supreme Court found that "each subsidiary operated as a distinct business enterprise at the level of fulltime management".[17] Nevertheless, the Supreme Court pointed out that there were some managerial links: Woolworth maintained one or several common directors with some of the subsidiaries; there was irregular in-person and "frequent" mail, telephone, and teletype communication between the upper echelons

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16 *Woolworth*, note 15 *supra*, 102 S.Ct. at 3133.

17 *Id.* 102 S.Ct. at 3136.

of management of the parent and subsidiaries; and decisions about major financial decisions, such as the amount of dividends to be paid by the subsidiaries and the creation of substantial debt had to be approved by the parent.

In concluding that the four Woolworth subsidiaries "are not part of the unitary business," the Court said:

> "Except for the type of occasional oversight--with respect to capital structure, major debt, and dividends--that any parent gives to an investment in a subsidiary, there is little or no integration of the business activities or centralization of the management of these five corporations.[18]

These two cases suggest that something more is needed than evidence of common ownership, high-level executive oversight and certain centralized nonoperating functions, such as accounting, legal and financing services; and something more than just adding to the profit of the parent.[19]

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[18] *Id.* 102 S.Ct. at 3138.

[19] Justice O'Connor wrote an extensive and vigorous dissenting opinion in the *ASARCO* and *Woolworth* cases, in which she was joined by Justices Blackmun and Rehnquist. The control requirement of a unitary subsidiary, as viewed by the dissent, calls for far less direction of, or participation in, the policies or management of the affairs of the subsidiary than does the majority.

But the majority opinion in *ASARCO* and *Woolworth* stands in contrast to the Court's decision decided a year later (1983) in the *Container* case.[20]

In *Container*, it was argued that the California state court employed an improper legal standard in reaching its conclusion that a unitary operation existed; that the state court erred in treating the taxpayer's "potential" to control the operation of its subsidiaries as a dispositive factor. (This argument was based on the *ASARCO-Woolworth* decisions.) The *Container* Court was not convinced by Container Corp.'s argument in this respect, and concluded that the state court properly relied on its finding that high officials of Container Corp. gave directions to subsidiaries for compliance with the parent's standard of professionalism, profitability, and ethical practice. The *Container* Court held that the taxpayer's assistance to its foreign subsidiaries in the form of equipment and personnel needs, loaning funds and guaranteeing loans, giving substantial technical assistance, and the supervisory role played by the corporate officers in providing general guidelines to the subsidiaries was sufficient to tax the enterprise as a single entity.

Container Corp. also urged the Court to adopt a "bright-line" rule requiring that there must be "a substantial flow of goods" between corporations, as a prerequisite to finding that a mercantile or manufacturing enterprise is unitary. The *Container* Court specifically declined to adopt this test, noting that "[t]he prerequisite

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20 *Container*, note 7, *supra*.

to a constitutionally acceptable finding of a unitary business is a flow of value, not a flow of goods. As we reiterated in *F. W. Woolworth*, a relevant question in the unitary business inquiry is whether "contributions to income [of the subsidiaries] result[ed] from functional integration, centralization of management, and economies of scale. (citations omitted) [S]ubstantial mutual interdependence" (citations omitted) can arise in any number of ways; a substantial flow of goods is clearly one but just as clearly not the only one."[21]

The United States Supreme Court indicated that in *ASARCO* and *Woolworth* that with better presentation of the facts at the trial level, a unitary determination could well have been established. Noteworthy distinctions exist between the Woolworth and Super Valu factual situation: in *Woolworth*, unlike with Super Valu/County Seat, each subsidiary was responsible for obtaining its own financing from sources other than the parent; and each Woolworth subsidiary, unlike Super Valu/County Seat, had a complete accounting department and financial staff; and none of the Woolworth subsidiary officers, unlike County Seat, was a current employee or board member of the parent.

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[21] *Container*, note 7 *supra*, 77 L.Ed. at 561. It has been noted that *Container* was decided after *ASARCO* and *Woolworth*; and the Container decision acts to modify whatever encouragement corporations may have taken in their efforts to avoid unitary classification.

POST-ASARCO, *WOOLWORTH*, *CONTAINER* DECISIONS

Since 1982, state courts have ruled on the scope of a "unitary business", embodying principles set forth in *ASARCO - Woolworth - Container* cases. The California State Board of Equalization handed down a series of decisions reflecting a pullback from the traditional broad view espoused in earlier decisions. The Court of Appeal of California applied the *Woolworth* analysis to find that no unitary business existed in cases where there was no "flow of goods"[22] despite intercompany financing[23] or

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22 *Appeal of C. H. Stuart*, Cal. S.B.E. Nov. 14, 1984, CCH ¶ 400-977, P-H ¶ 13,112-U, involving a corporation that manufactured jewelry and china. It was held not to be unitary with four subsidiaries that respectively imported furniture, manufactured furniture, manufactured boats, and sold arts and crafts. In addition to providing budgeting, accounting, and legal services, the parent furnished financing. The Court held there was no "flow of goods" required for a unitary business.

23 *Appeal of Santa Anita Consolidated, Inc.*, Cal S.B.E. April 5, 1984, CCH ¶ 400-814, P-H ¶ 13,110-D. A parent company that provided financing as well as accounting, legal, insurance, and management services, was not unitary with subsidiaries engaged in horse racing, transportation and delivery of automobiles, and real estate development.

the use of common centralized services[24] or interlocking officers or directors.[25]

While California has moved in the direction of a restrictive view of what constitutes a unitary business, many, if not the majority, of state courts have sustained determinations that the taxpayer is engaged in a unitary business with its affiliates or subsidiaries, based on an expansive view of the three-pronged test set forth in *Mobil Oil* and reiterated in *Container* (functional integration, centralized management, economies of scale).

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[24] *Appeal of National Dollar Stores, Ltd.*, Cal . S.B.E., Sept . 9, 1986, CCH ¶ 401-403, P-H ¶ 13,014 . A California corporation engaged in the retail business was held not to be unitary with its wholly owned subsidiary engaged in the acquisition of foreign films in the United States, despite the use of common legal and accounting firms and the provision of financing by the parent to the subsidiary. Similarly in *Appeal of Specialty Restaurant Corp.*, Cal. S.B.E., Sept. 9, 1986, CCH ¶ 401-413, P-H ¶ 13 ,017, a California corporation engaged in the restaurant business located near airports and featuring restored aircraft was held not to be unitary with subsidiaries engaged in the purchase of aircraft for resale, despite intercompany financing and the use of common centralized services.

[25] *Appeal of Vidal Sassoon of N.Y., Inc.*, Cal. S.B.E., June 27, 1984, CCH ¶ 400-888, P-H ¶ 13,111-A. Despite interlocking directors, the use of a common trade name, the operation of similar businesses, and some intercompany financing, the S.B.E. found no unitary business, pointing to the independence of each group's operation in style development and purchasing; the absence of centralized advertising, accounting, or management divisions, and little exchange of information or know-how.

Functional integration was found to exist in loan and loan guarantees made by the parent to the subsidiary, the existence of company-wide retirement plans, the holding of annual meetings with the subsidiary, preparation of tax returns at the corporate level and providing centralized services; centralization of management was found to exist where there was interlocking directors and officers, centralized administrative services, common insurance plans, company-wide payroll processing; and economies of scale were found where there was a flow of value associated with use of funds generated by the subsidiary, elimination of interest expense attributable to subsidiary financing, providing centralized services and umbrella insurance policies and commingling of funds.[26]

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[26] *See: Earth Resources Co. of Alaska v. Dept. of Revenue*, 665 P.2d 960 (1983) Earth Resources Co. (ERC), parent of the subsidiary-taxpayer, Earth Resources Co. of Alaska (ERCA), had its principal place of business in Dallas, Texas. Subsidiaries (other than ERCA) operated a refinery in Tennessee, a tug and barge on the Mississippi River, and a chain of gasoline stations operating in the midwest. ERC, the parent, was engaged in mining operations in Oregon, New Mexico and Colorado.

ERCA was set up for the purpose of building a refinery in Alaska, but it purchased an Alaskan paving and contracting company. The parent, ERC, guaranteed or provided all the financing. "Functional integration" was found to exist in the loan and loan guarantees, and the company-wide retirement plan. "Centralized management" was found to exist because (unlike the situation in *Woolworth* where none of the subsidiary officers was a current or former employee of the parent) the president of ERCA was president, chief executive officer, and a director of ERC. Similarly, a vice-president, treasurer, and

(Footnote 26 continued on page 55a)

The fact that portions of the business enterprise may be dissimilar and that their common links are

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(Footnote 26 continued from page 54a)

director of ERCA was executive director of ERC; and an assistant secretary of ERCA served as staff attorney for ERC. "Economies of scale" were found where there was an umbrella insurance for health and life insurance, where a management fee was paid by ERCA to ERC (thereby providing an economic benefit to ERC), and where ERCA was able to obtain lower financing rates because of ERC's assistance.

Albertson's, Inc. v. State Department of Revenue, 106 Idaho 810, 683 P.2d 846 (1984). Albertson's Inc., an owner and operator of chain retail grocery supermarkets formed a wholly owned subsidiary, Texas-Albertson's, Inc., a holding company for Albertson's partnership interest in Skaggs-Albertson's, operator of "superdrug stores". Texas-Albertson's was operated as a branch or division of Albertson's. Not only were all its officers and directors employees of the parent company, but Texas-Albertson's had no payroll and "[e]very decision made by Texas-Albertson's was actually made by Albertson's employee". The parent company furnished Texas-Albertson's initial operating capital and there was no written agreement for repayment of capital or interest. Held: Texas-Albertson's was engaged in a unitary business with its parent.

Revenue Cabinet v. Kawneer Co., ___ S.W.2d ___ (Ky. 1987). The narrow view adopted in *Square D. Co.* (*supra*, footnote 12) has been abandoned and a broad view of the unitary business was pronounced in this 1987 case by the Kentucky Supreme Court. The Kawneer Corporation, a wholly-owned subsidiary of Alumax, was incorporated and headquartered in Michigan. Kawneer operated through three divisions: an extension die division located in Indiana; an appliance division located in

(Footnote 26 continued on page 56a)

through management and financing have not precluded state courts, in the wake of *ASARCO - Woolworth - Container*, from finding that those portions were part of

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(Footnote 26 continued from page 55a)

Kentucky; and an architectural division located in various states. Kawneer claimed its Kentucky appliance product division (Revenue Cabinet) was not engaged in a unitary business with the other two division because it furnished no funds to either of the other divisions (although its parent, Alumax, did); its marketing, research, and centralized purchasing were for the sole benefit of the architectural division; and it furnished no advertising, legal, marketing, sales or other services to its appliance products division.

The court, however, found evidence of functional integration, centralization of management, and economies of scale between the business on the basis of the following interconnections: the appliance division reported to Kawneer regularly on capital expenditures, and had to receive approval on all expenditures over $2,500; Kawneer provided centralized services such as fringe benefits, union negotiations; the interest portion of the bond that financed the Kentucky plant was assumed by and handled by Kawneer. The court found a "flow of value" indicative of businesses that are "substantially interwoven".

Ward Paper Co. v. Department of Revenue, 638 P.2d 1053 (1981). This case was remanded to the Montana Court for reconsideration following *ASARCO* and *Woolworth*, *Russell Stover Candies, Inc v. Department of Revenue*, 459 U.S. 808 (1982). On that remand, the Montana Court affirmed its prior holding that two ranches owned and operated by a taxpayer in Montana were unitary with the taxpayer's manufacture and sale of paper boxes and paper products in other states, *Russell Stover Candies, Inc. v. Department of Revenue*, 665 P.2d 198 (Montana 1983), appeal dismissed for want of a substantial federal question, 464 U.S. 988, 104 S.Ct. 475 (1983).

(Footnote 26 continued on page 57a)

the same unitary business: Decisions from states adjacent to Iowa with factual situations similar to Super Valu indicate an expansive view of the scope of a unitary

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(Footnote 26 continued from page 56a)

The taxpayer, Russell Stover Candies, was based in Kansas City, Kansas, manufactured and sold its products through its divisions in six states. It also owned the two Montana ranches that were operated by other divisions of the corporation. None of the taxpayer's divisions exchanged equipment or personnel; there was no joint purchasing of products or joint advertising; nor was there any flow of products between the Montana ranch division and the other divisions.

In reaffirming its earlier decision that the ranch business was unitary with the taxpayer, the Montana Court cited the fact that central administrative or other services were furnished to the ranch divisions by the taxpayer's Kansas City office. That office kept the books and records of the ranches, prepared financial statements and tax returns for the entire enterprise, transferred funds from the other divisions to the ranch division when needed and handled bank deposits. Moreover, there was centralized management: The directors and officers of the parent approved or made all major decisions with respect to ranching activity equipment and buying and selling cattle. On these facts the court held there was "functional integration" and "centralized management".

See also: *Silent Hoist & Crane Co., Inc. v. Director, Division of Taxation*, 100 N.J. 1, 494 A.2d 775 (1985); *AVCO Corp. v. State Tax Comm'n* (Mass. App. Tax Bd., Aug. 4, 1983), P-H ¶13,638; *Comptroller of the Treasury v. Ramsay, Scarlett & Co.*, 58 Md. App. 327, 473 A.2d 469 (1984) - (Although this decision was later reversed because the Court of Appeals applied an overly broad standard of appellate review, it retains significance as an opinion delineating the scope of a unitary business).

business. Such states include Illinois,[27] Minnesota,[28] Missouri,[29] Wisconsin,[30] and Nebraska.[31]

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[27] *Citizens Utils. Co. of Ill. v. Department of Revenue*, 111 Ill.2d 32, 488 N.E.2d 984 (1986). The taxpayer was a regulated utility engaged in supplying water and treating waste water. The Illinois Supreme Court held it was carrying on a unitary business with its parent and the parent's 24 other subsidiaries who were conducting a similar business in states other than Illinois. The taxpayer and all other subsidiaries shared the same officers and interlocking board of directors. While local managers controlled day to day management of the subsidiaries, the parent had to approve all purchases exceeding $500. The parent provided centralized functions, including legal and accounting services at cost. Revenues received by the taxpayer, were subject to the parents control and use and could be withdrawn by the parent at will. The court found "economies of scale" generated by the provision of centralized services and on the flow of value associated with the use of funds by the controlled group. Relying on *Container* the court found "a flow of value" where the parent can withdraw and utilize the funds of the subsidiary; and where both the borrowing and lending corporations are governed by the same directors, officers and management strategies. The Court held that "[t]his flow of value is, in itself, strong[ly] indicative of a unitary business".

[28] *The Commissioner of Revenue v. Associated Dry Goods, Inc.*, 347 N.W.2d 36 (Minn. 1984). The Minnesota Supreme Court upheld a tax court determination that Associated Dry Goods Corp. was conducting a unitary business in that state. Associated conducted a retail business through a retail ownership group with separate stores set up as separate divisions. Each of the divisions operated several retail department stores, with each of the divisions operated independently, catering to different sections of society, carrying different merchandise lines, and using different methods of operation. Only one division operated in Minnesota, Power Dry Goods, and formal control of all divisions

(Footnotes 28, 29, 30 and 31 continued on page 59a)

(Footnotes 28, 29, 30 and 31 continued from page 58a)

was lodged in a single set of directors and officers in New York. Day to day operations were managed by local division officers. Power Dry Goods made its own purchases, trained its own employees, owned its own equipment and delivery fleet, did its own accounting, had its own bank and legal counsel, and did its own advertising.

The New York officers of Associated oversaw such matters as audits, preparation of tax returns, purchases or insurance, and management of the employee pension plan. In addition, they provided information and, for a fee, assisted the divisions in making purchasing decisions. Nevertheless, less than 10 percent of total purchases were "group" purchases. Although Associated's corporate officers would occasionally merge or close stores that were unprofitable, most decisions regarding expansion or renovation were made at the division level. As income was accumulated in a division, it would be transferred to New York, where it was commingled with other corporate funds. As a division needed financing to maintain sufficient balances at local banks or to fund capital improvements, the New York office would lend funds back to the divisions. Major renovations or new buildings had to be approved for funding by Associated's board of directors.

The Minnesota Supreme Court relied on the U.S. Supreme Court's tests of "functional integration" and "economies of scale" in holding the business unitary. It said:

> "There is. . .evidence of functional integration for example, the sharing of information, some group buying, periodic reports and conferences, preparation of tax returns at the corporate level, centralized purchasing of casualty insurance, one pension plan, and various consulting services. Finally, there is evidence of economies of scale;

(Footnotes 28, 29, 30 and 31 continued on page 60a)

APPLICATION OF UNITARY BUSINESS CONCEPT TO SUPER VALU/COUNTY SEAT

Under *Container*, "the prerequisite to a constitutionally acceptable finding of a unitary business is a flow of value not a flow of goods"; and using traditional judicial concepts of the unitary business concept set forth in *Mobil Oil*, the *Container* Court asked whether there are contributions to the income of the subsidiaries or affiliates in question resulting from functional integration, centralization of management and economies of scale.

The parallel between the facts in *Container* and those in this case is striking. In almost every respect Super Valu's operational relationship with County Seat was as close as or greatly exceeded that which existed between Container Corp. and its subsidiaries. Container Corp. (like Super Valu) was solely responsible for payroll administration. County Seat, like the Container Corp.

(Footnotes 28, 29, 30 and 31 continued from page 59a)

> funds are commingled and used to fund capital improvements and for loans back to the divisions.
>
> . . .

29 *Bank Bldg. & Equipment Co. of America v. Director of Revenue*, 687 S.W.2d 168 (Mo. 1985).

30 *W. R. Grace & Co. v. Wisconsin Commissioner of Revenue*, Wisconsin Tax Appeals Commission, Feb. 12, 1985 CCH ¶ 202-527.

31 *Pentzien, Inc. v. Nebraska Dept. of Revenue*, 418 N.W.2d 546 (Neb. 1988); *PMD Investment Co. v. State*, 216 Neb. 553, 345 N.W.2d 815 (1984).

subsidiaries, was relatively autonomous in matters of personnel and day to day management. It was held in *Container* that although day-to-day management responsibilities may be in the hands of local executives, this alone is insufficient to defeat a unitary business finding.[32] Four Container Corp. officers were engaged in overseeing the subsidiaries; and the Container subsidiaries had some Container Corp. directors and officers on their board of directors who did not generally play an active role in management decisions. Super Valu, like Container Corp., had interlocking directors and officers with County Seat; and, like Container Corp., Super Valu charged one of its vice-presidents, Wm. S. Bailey, with the task of overseeing its subsidiary. The comment of the *Container* Court[33] is equally applicable to Super Valu:

> These officers established general standards of professionalism, profitability, and ethical practices and dealt with major problems and long-term decisions.

Every County Seat member of the Board of Directors was a Super Valu officer and board member. The General Manager of County Seat, Wm. S. Bailey, was hired by Super Valu and later was appointed as a member of the board of both Super Valu and County Seat. At the time of the sale of County Seat stock, County Seat had twelve

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[32] *See also Pentzien, Inc. v. State Dept. of Revenue, id.* 418 N.W.2d at 551.

[33] *Container, supra,* 77 L.Ed.2d 558.

officers, five of whom were executive officers of Super Valu. Every major decision made by County Seat was actually made by Super Valu officers or board members. Super Valu conducted an annual review and approval of County Seat's operating and capital budgets, and had final authority to determine the number of new stores County Seat could open.

As was the case in *Container*, Super Valu's employees performed administrative functions on behalf of County Seat, including keeping books, tax return preparation, and preparation of corporate documents.

The *Container* Court considered as a particularly relevant factor, the fact that the parent held or guaranteed half of the subsidiaries long-term debt. Super Valu furnished or guaranteed all of County Seat's initial operating capital. Super Valu guaranteed leases entered into by County Seat. One of the factors considered by the *Container* Court was "the substantial role played by [Container] in loaning funds to the subsidiaries and guaranteeing loans to others."[34] There was a "flow of value" between Super Valu and County Seat similar to that between Container and its subsidiaries.

In *Container* the Court considered as a critical factor the "considerable interplay between [Container] and its foreign subsidiaries in the area of corporate expansion".[35] Super Valu, as previously noted, had final authority, in effect, to determine County Seat's corporate expansion.

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[34] 77 L.Ed.2d at 562.

[35] *Id.*

A final factor considered by the *Container* Court was "the substantial technical assistance provided by appellant to the subsidiaries,. . .and the supervisory role played by appellant's officers in providing general guidance to the subsidiaries". Super Valu provided tax planning services, marketing services consisting of sales projections, financial services and cash management, legal services, architectural and engineering services, and company-wide insurance benefits.

The *Container* Court emphasized that two factors deserved special consideration in deciding the unitary issue: the first factor "is the flow of capital resources from [Container] to its subsidiaries through loans and loan guarantees; and the second factor "is the managerial role played by [Container] in its subsidiaries' affairs".[36] Both of these factors were present as regards Super Valu. Unlike *Woolworth* and like *Container*, Super Valu engaged in more than "occasional oversight" with respect to capital structure and major debt. County Seat had day-to-day management responsibility, but as the *Container* Court noted, "mere decentralization of day-to-day management responsibility and accounting cannot defeat a unitary business finding".[37]

Each criterion suggested by the Supreme Court in *Container* before a unitary business can be found is met by the close operational relationship which existed between Super Valu and County Seat.

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[36] 77 L.Ed. at 562.

[37] *Id.*

DECISION

Contributions to the income of the subsidiary resulted from the functional integration, centralization of management and economies of scale between Super Valu and its subsidiary, County Seat. For that reason, Super Valu was engaged in a unitary business operation and is subject to Iowa taxation on an apportionment formula basis rather than on a separate accounting basis. Super Valu's capital gain on the sale of County Seat stock is part of Super Valu's apportionable business income. The Department's assessment is affirmed.

No affidavit has been filed by the Protestor under 701 Iowa Admin. Code § 7.9, seeking the deletion of identifying details in this case. There is no clearly unwarranted invasion of personal privacy or trade secrets in this case requiring deletion of identifying details under Iowa Code § 17A.3(1)(d) (1989).

This Director's decision is the final Order of the Iowa Department of Revenue and Finance.

Issued at Des Moines, Iowa, this 31st day of July, 1989.

IOWA DEPARTMENT OF
REVENUE AND FINANCE

By

G.D. Bair, Director

APPENDIX D

IOWA STATUTES AND REGULATIONS INVOLVED

IOWA CODE

Section 422.32. Definitions. For the purpose of this division and unless otherwise required by the context:

. . .

6. "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

7. "Nonbusiness income" means all income other than business income.

8. "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

. . .

Section 422.33. Corporate tax imposed — credit.

1. A tax is imposed annually upon each corporation organized under the laws of this state, and upon each foreign corporation doing business in this state, or deriving income from sources within this state. . . .

. . .

2. If the trade or business of the corporation is carried on entirely within the state, the tax shall be imposed on the entire net income, but if the trade or business is carried on partly within and partly without the state or if income is derived from sources partly within and partly without the state, the tax shall be imposed only on the portion of the net income reasonably attributable to the trade or business or sources within the state, with the net income attributable to the state to be determined as follows:

a. Nonbusiness interest, dividends, rents and royalties, less related expenses, shall be allocated within and without the state in the following manner:

. . .

(4) Nonbusiness capital gains and losses from the sale or other disposition of assets shall be allocated as follows:

. . .

Gains and losses from the sale or disposition of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

. . .

b. Net nonbusiness income of the above class having been separately allocated and deducted as above provided, the remaining net business income of the taxpayer shall be allocated and apportioned as follows:

. . .

(2) Capital gains and losses from the sale or other disposition of assets shall be apportioned to the state based upon the business activity ratio applicable to the year the gain or loss is determined if the corporation determines Iowa taxable income by a sales, gross receipts or other business activity ratio. . . .

. . .

(4) Where income is derived from the manufacture or sale of tangible personal property, the part attributable to business within the state shall be in that proportion which the gross sales made within the state bear to the total gross sales.

. . .

Sec. 422.35. Net income of corporation—how computed. The term "net income" means the taxable income before the net operating loss deduction, as properly computed for federal income tax purposes under the Internal Revenue Code. . . .

IOWA ADMINISTRATIVE CODE

Rule 701—54.1(422). Basis of corporate tax.

Iowa Code section 422.33 imposes a tax on all corporations incorporated under the laws of Iowa and upon every foreign corporation doing business in Iowa. For corporations or other entities subject to the tax (as

corporations), the tax is levied and collected only on such income as may accrue or be recognized to the corporation from business done or carried on in the state plus net income from certain sources without the state which by law follows the commercial domicile of the corporation.

. . .

Rule 701—54.2(422). Allocation or apportionment of investment income.

54.2(1) The classification of investment income by the labels customarily given them, such as interest, dividends, rents, and royalties, is of no aid in determining whether that income is business or nonbusiness income. Interest, dividends, rents and royalties shall be apportioned as business income to the extent the income was earned as a part of a corporation's unitary business, a portion of which is conducted in Iowa. *Mobil Oil Corp. v. Commissioner of Taxes*, 455 U.S. 425 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 73 L.Ed. 2d 787, 102 S.Ct. 3103 (1982); *F.W. Woolworth Co. v. Taxation and Revenue Dept.*, 458 U.S. 354, 73 L.Ed. 2d 819, 102 S.Ct. 3128 (1982); *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159, 77 L.Ed. 2d 545, 103 S.Ct. 2933 (1983). Whether investment income is part of a corporation's unitary business income depends upon the facts and circumstances in the particular situation. The burden of proof is upon the taxpayer to show that the treatment of investment income on the return as filed is proper. There is a rebuttable presumption that an affiliated group of corporations in the same line of business have a unitary

relationship, although that is not the only element used in determining unitariness.

. . .

Rule 701—54.4(422). Net gains and losses from the sale of assets.

. . .

(1) Gain or loss from the sale, exchange or other disposition of real or tangible or intangible personal property, if the property while owned by the taxpayer was used in the taxpayer's trade or business, shall be apportioned as follows:

> Corporations determining Iowa taxable income by a ratio of sales, gross receipts, or other business activity ratio, shall apportion gain or loss from the sale or exchange of assets used in the trade or business by the business activity ratio applicable to the year the gain or loss is determined.

. . .

(2) Gain or loss from the sale, exchange or other disposition of property not used in the taxpayer's trade or business shall be allocated as follows:

. . .

> c. Gains or losses from the sale, exchange or other disposition of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.